

State of California:

**Improvements Have Occurred
in Controlling Costs, but Some
Problems Remain**

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June 27, 1996

95002

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

The Bureau of State Audits presents the results of our review of the State's control of its financial activities and its compliance with federal grant requirements and state regulations. This review was made as part of our examination of the State's general purpose financial statements. This report fully meets the requirements of the 1984 Single Audit Act set forth by the United States Government as a condition of receiving \$26 billion in federal funds annually. The Bureau of State Audits, which was created in May 1993, pursuant to the California Government Code, Section 8543, is responsible for performing the annual financial and compliance audit previously conducted by the Office of the Auditor General.

The State has made numerous improvements in its system of controls in response to weaknesses reported in prior years. For example, for fiscal years 1982-83 through 1993-94, the Office of the Auditor General or the Bureau of State Audits reported that the State Controller's Office (SCO) issued financial statements in general conformity with the State's budgetary basis of accounting, which is not in accordance with generally accepted accounting principles (GAAP). The budgetary basis statements were then converted to GAAP for the State's general purpose financial statements. However, for the year ended June 30, 1995, the SCO issued a Comprehensive Annual Financial Report that included the State's general purpose financial statements prepared in accordance with GAAP. In another example, we reported that for fiscal year 1993-94 the Department of Motor Vehicles failed to allocate approximately \$9.2 million in cash collections to programs supported by department revenue. This problem originated before fiscal year 1985-86 when it appeared the department deposited cash in the uncleared collections account of the SCO, but the deposits were not subsequently transferred to the correct

revenue accounts. Since we reported this issue in last year's audit, the department has reconciled its balance to the SCO's uncleared collections account balance so these revenues can finally be used for their intended purpose.

While the State has addressed many of the concerns we reported in earlier audits, it continues to experience some weaknesses in its accounting, auditing, and administrative control structure. For example, we found inadequacies in the State's monitoring of recipients of state and federal moneys. As a result, the State cannot ensure that the recipients are complying with regulations or laws governing the receipt or use of these moneys. In addition, we noted instances in which the State failed to either promptly request federal funds to reimburse it for expenditures paid from the General Fund or promptly reimburse the federal government for excess funds the State received. Thus, the State unnecessarily lost interest earnings or incurred a liability to the federal government.

Respectfully submitted,

A handwritten signature in black ink, reading "Kurt R. Sjöberg". The signature is written in a cursive, flowing style with a large, prominent "K" and "S".

KURT R. SJOBERG
State Auditor

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Summary

The State has improved its control over many of the expenditures it incurs. However, weaknesses in accounting and administrative practices continue to cause inaccurate financial reporting and noncompliance with some state and federal regulations. Although these problems are not significant individually, they have a cumulative effect on the accuracy of the financial information departments prepare. The following are some of the specific weaknesses we found:

- The Department of Health Services overstated its Medi-Cal accrual by \$703 million because it did not adjust prior-year estimates to reflect current projections for costs. As a result, the department overstated both receivable and liability accounts for the Health Care Deposit and Federal Trust funds and liability accounts for the General Fund.
- The Department of Corrections and California State University (CSU) incorrectly accounted for construction costs totaling approximately \$498 million and \$48 million, respectively. These amounts were misclassified in the State's financial statements because the department and the CSU Chancellor's Office did not notify various state correctional institutions and campuses that the construction projects were completed so that they could record the costs in their building or improvement accounts. In addition, \$68.6 million of the completed projects for CSU were not reported to the State Controller's Office (SCO), resulting in an understatement of the building accounts included in the State's financial statements.
- The Stephen P. Teale Data Center did not fully recover some costs of providing services for a Department of Motor Vehicles (DMV) project for which the incurred costs exceeded billings by more than \$3.1 million. The data center could have reduced some of its costs if it had followed its standard procedure of billing customers at existing rates for actual system services used rather than basing the billing on the number of transactions processed by the DMV at a new rate. The data center used surpluses accumulated from past years to recover a portion of the project costs, thereby passing those costs on to other state agencies.
- The State has numerous deficiencies in monitoring recipients of federal or state monies. We found 24 federal and 2 state programs at 13 departments deficient in required monitoring practices. Without adequate monitoring, the State cannot ensure that the recipients are complying with regulations or laws governing the receipt or use of these monies. As an example of noncompliance, the Office of Public School Construction (OPSC) has not finalized close-out audits on approximately 723 completed school construction projects, even though 174 of these projects have been complete for at least four years. As a result, the OPSC cannot determine the amount of allowable expenditures, whether the State owes school districts additional funds, or if any excess funds are to be returned to the State and made available for other projects.

- State departments have numerous deficiencies in preparing accurate state and federal financial reports and reconciling financial information in those reports to the accounting records. We found at least five departments that inaccurately prepared state financial reports and seven departments whose federal reports contained discrepancies. In addition, we found five departments that failed to perform reconciliations of state financial reports to accounting records and five departments that failed to perform reconciliations of federal financial reports to accounting records. Failure to correctly report financial information or reconcile it with accounting records reduces the State's ability to prepare financial statements in accordance with generally accepted accounting principles (GAAP), and failure to complete accurate federal reports or reconcile them to accounting records can result in misstated claims that are not supported or accurate and may remain undetected.
- The Department of General Services overstated the June 30, 1995, inventory balance in financial statements submitted to the SCO by approximately \$269,000 because it did not properly account for the inventory. In addition, the department did not adequately control its inventory because its machine repair technicians routinely removed machine components from inventory and stored them on their desks, in their vans, or at other locations without maintaining a log or list of inventory in their possession.

We noted these deficiencies during our annual financial and compliance audit of the State. Procedures we perform during this audit include evaluating internal controls over activities that can directly affect financial statements and controls required for receiving federal funds. The audit does not deal directly with the economy, efficiency, or effectiveness of the State's administration, although such issues may arise during our audit.

Although these weaknesses exist in the State's control structure, the State has also made significant improvements in certain areas. These improvements resulted from its response to weaknesses the Bureau of State Audits and the Office of the Auditor General reported in prior years. The following are examples of such improvements:

- For fiscal years 1982-83 through 1993-94, the Office of the Auditor General or the Bureau of State Audits reported that the SCO issued financial statements in general conformity with the State's budgetary basis of accounting, which is not in accordance with GAAP. The State's budgetary basis statements were then converted to GAAP to generate general purpose financial statements. On February 28, 1996, the SCO issued a Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 1995, that included general purpose financial statements prepared in accordance with GAAP.
- For fiscal year 1993-94, the Bureau of State Audits reported that the DMV failed to allocate approximately \$9.2 million in cash collections to programs supported by DMV revenue. This problem originated before fiscal year 1985-86, when it appeared the DMV deposited cash in the uncleared collections account of the SCO, but the deposits were not subsequently transferred to the correct revenue accounts. Since we reported this issue in last year's audit, the DMV has reconciled its balance to the SCO's uncleared collections account balance so that these revenues can finally be used for their intended purpose.

- For fiscal years 1987-88 through 1993-94, the Office of the Auditor General or the Bureau of State Audits reported that the State's general purpose financial statements omitted financial information from district agricultural associations. Organized to hold fairs and expositions, the associations are funded by appropriations in the State's annual budget and are considered component units of the State. For fiscal year 1994-95, the SCO included in the State's general purpose financial statements financial information from the district agricultural associations.
- For fiscal year 1991-92, we reported that the Board of Equalization did not have a policy to assess penalties on the underpayment of required fuel tax prepayments. At that time, the senior auditor for the board's fuel taxes division stated that there was no provision in law to assess penalties on these underpayments. However, after we brought this matter to its attention during fiscal year 1994-95, the board notified us in April 1996 that it plans to assess penalties on underpayment of required fuel tax prepayments, thus providing the State with an additional revenue source.
- For fiscal year 1993-94, the Bureau of State Audits reported that the Department of Housing and Community Development could not reconcile a difference of approximately \$25.4 million between its accounting records and program records for its housing funds. In response to the audit, the department hired an independent CPA firm to reconcile its accounting and program records. The CPA firm proposed adjustments to the accounting records totaling \$17.6 million. The CPA firm also developed procedures for the department to prepare monthly reconciliations of accounting and program records. However, as of April 1996, the department has not performed any of these monthly reconciliations for fiscal year 1995-96 loan receivable activity.

Introduction

As part of our examination of the general purpose financial statements of the State of California for fiscal year ended June 30, 1995, we studied and evaluated the State's internal controls. This study was necessary for the following three reasons:

- To express an opinion on the State's general purpose financial statements;
- To determine compliance with federal grant requirements, laws, and regulations; and
- To determine compliance with state laws and regulations that could materially affect the general purpose financial statements.

Our first step was to determine the audit procedures and the extent of testing necessary. During our audit, we reviewed and evaluated fiscal controls at 22 of the 193 state agencies included in the general purpose financial statements.

Amounts that we audited at these agencies represented approximately 62 percent of the State's revenue and approximately 64 percent of the State's expenditures. Other independent auditors audited an additional 28 percent of the State's revenues and 13 percent of its expenditures. We increased our coverage with centralized testing, for which we selected a cross section of items from the State as a whole. For example, we selected a sample of payroll warrants the State processed through its payroll system and a sample of other warrants the State processed through its claims payments system. We also reviewed electronic data processing activities at selected state agencies that have significant data processing operations.

We reviewed the compliance of 16 agencies with state laws and regulations that materially affect the State's financial statements. Such compliance helps to ensure that the State maintains sufficient control over the budgeting, investing, collecting, and disbursing of state money and reporting the results of state financial activities.

Finally, except for the federal grants administered by California State University and the University of California, which are reviewed by other independent auditors, we reviewed the State's compliance with federal regulations for all federal grants exceeding \$20 million. We reviewed 57 of the 384 federal grants the State administers. These 57 grants represent approximately 95 percent of the federal funds the State received in fiscal year 1994-95, excluding those funds California State University and the University of California received. We also selected transactions related to other federal programs and reviewed these transactions for compliance with applicable federal regulations.

The specific scope of our audit is stated in the following reports that the federal Office of Management and Budget, Circular A-128, requires the State to issue each year:

- The report on the internal control structure used in preparing the general purpose financial statements and in administering federal assistance programs (begins on page 29);
- The report on weaknesses and instances of noncompliance with state and federal laws and regulations at state agencies (begins on page 35);
- The report on federal assistance programs, including required reports on compliance with laws and regulations related to major and nonmajor federal programs, and reports on the resolution of prior-year findings related to federal programs (begin on page 217);
- The report on the accuracy of the supplementary schedule of federal assistance (begins on page 223); and
- The report on compliance with state laws and regulations (begins on page 271).

Between July 1, 1994, and December 31, 1995, the Bureau of State Audits issued 46 audit reports, many of which discussed improvements needed in the State's operations. These reports, listed in the appendix, are available to the public through the Bureau of State Audits.

Statewide Concerns

Summary

The State has made numerous improvements in its system of controls. However, some weaknesses in this system warrant statewide concern. These weaknesses exist in many departments throughout the State, arise from current policies that do not satisfactorily address the State's needs, and have the potential to impact fiscally either the State as a whole or a segment of the State.

Generally, the statewide concerns fall into two main categories: problems with financial reporting and problems of compliance with state or federal requirements. Problems with financial reporting can result in inaccurate or incomplete financial statements. The following issues are examples of problems with financial reporting:

- Inadequate reporting of financial information;
- Failure to require departments to submit important financial reports to the State Controller's Office (SCO) to improve the reliability of the State's general purpose financial statements; and
- Deficiencies in accounting for and controlling the State's equipment.

Problems of compliance with federal and state policies can result in a lack of assurance that the State or its subrecipients comply with state and federal laws and regulations. The following issues are examples of these problems:

- Inability to account for expenditures of federal monies by each federal program;
- Lack of monitoring of cash advances to subrecipients; and
- Lack of monitoring of recipients of federal and state money.

Some of the statewide concerns have been reported for years and remain unresolved because they require the coordinated efforts of many agencies or the expenditure of scarce resources.

Financial Reporting Problems

The statewide concerns related to financial reporting problems impact the State's ability to produce financial statements that are timely, accurate, complete, and consistent with generally accepted accounting principles (GAAP).

Leasing Information Is Inadequate

The State does not have centralized records that contain all the necessary information required by GAAP for financial statement disclosures on lease commitments. Without centralized records, the State spends unnecessary time and effort gathering and summarizing the required information. The State's lease commitments totaled approximately \$5.8 billion in fiscal year 1994-95.

Governmental accounting and reporting standards require the fair presentation and full disclosure of the governmental entity's financial position and results of financial operations in accordance with GAAP. In addition, the California Government Code, Section 12460, requires the SCO to present the State's financial position in a format that is as close as possible to GAAP. When it leases space or equipment from outside vendors, GAAP requires the State to disclose commitments for future minimum lease and rental payments in a summary that separates these future payments by fiscal year.

Although the Department of General Services maintains space and equipment records for many lease commitments, it established these records for internal management purposes rather than for maintaining a complete listing of the State's leases that would meet GAAP requirements. As a result, the records do not provide all the required information. For example, they do not indicate either the changes in payments in future years or the separate future lease and rental payments by fiscal year.

Although the Department of General Services converted in 1994 to a new system to maintain space and equipment records, additional programming work is required before the new system can provide the information required by GAAP. The records of the new system do not include information on those leases that the Department of General Services does not oversee. For example, the department's records do not include \$2 billion in lease commitments with the State Public Works Board or more than \$3.7 million in lease commitments for the California State Lottery Commission. This issue has been reported previously.

Agencies Are Not Required To Prepare All Reconciliations or Reports of Accruals

At the end of each fiscal year, all state agencies submit financial reports to the SCO, which then issues a combined financial report presenting the State's financial position and results of operations. However, the State Administrative Manual, Section 7951, does not require agencies to submit the following two financial reports for more than 240 funds numbered 500 to 699 and 800 to 999:

- Report 15, Reconciliation of Agency Accounts With Transactions Per State Controller, is not submitted. As a result, the SCO does not have evidence that agencies have reconciled financial information that appears in the general purpose financial statements with its own records. The State Administrative Manual, Section 7900, discusses the importance of making regular reconciliations. Reconciliations represent an important element of internal control because they provide a high level of

confidence that transactions have been processed properly and that the financial records are complete. Reconciliation with the records of the SCO is an important step in ensuring the accuracy of each agency's financial statements.

- Report 1, Report of Accruals to the Controller's Accounts, also is not submitted. As a result, information needed to distinguish encumbrances from accounts payable and to present financial information in accordance with GAAP is not available for all funds. Both the California Government Code, Section 12460, and Section 1100.101 of the Governmental Accounting and Financial Reporting Standards issued by the Governmental Accounting Standards Board require using GAAP to present the State's financial position and results of operation.

Included among the 240 funds not requiring these two important financial reports are 73 that had budget appropriations for fiscal year 1994-95. Without the reconciliation and accrual information for these funds, the SCO cannot be assured that expenditures are within the budgeted limits. These weaknesses have been reported in prior years.

The SCO and the DOF Do Not Consistently Reconcile Differences in Fund Balances

The SCO and the Department of Finance (DOF) report on the State's budgetary basis financial condition using different accounting practices. However, while these different accounting practices may result in differences in fund balances for many of the State's funds, neither the SCO nor the DOF consistently reconcile these differences. We compared the SCO and DOF fiscal year 1994-95 fund balances for five funds and noted differences in all five instances. The differences ranged from approximately \$3.5 million to \$1.1 billion. For example, for fiscal year 1994-95, the SCO reported a General Fund deficit of \$394 million and the DOF reported a General Fund balance of \$683 million in the Governor's Budget, resulting in a difference of \$1.077 billion for the same reporting period. In addition, the SCO reported a fund balance in the State Highway Account of \$1.098 billion, while the DOF reported a fund balance of \$380 million, a difference of \$718 million. While the SCO reconciled the fiscal year 1994-95 General Fund difference, it did not complete the reconciliation until May 31, 1996. Moreover, neither the SCO nor the DOF reconciled the differences in fund balance for the remaining four funds we reviewed.

Inconsistent accounting practices and the resulting differences in fund balances provide the State's financial decision makers and the investment community with conflicting information about the State's true financial condition. For example, the State Treasurer's Office discloses in its prospectus for the sale of state bonds that the SCO and the DOF use different accounting practices. The disclosure is important because the schedules prepared by the two entities, which are included in the prospectus, do not agree with each other. In addition, because the DOF's records are used in the State's budgeting process, the inability to account for the differences adequately may impair the integrity of the budgeting process.

Deficiencies Exist in Accounting for and Controlling State Equipment

State agencies do not consistently comply with the State Administrative Manual in accounting for and controlling their equipment. Specifically, some departments do not report the full purchase price of equipment, including tax and shipping, when recording the cost of additions in the general ledger, or they do not include the full cost of the equipment in the inventory listing. Also, departments do not always properly authorize or record deletions of equipment. Furthermore, we were not always able to trace items from the departments' inventory listings to the physical locations of the items. In addition, we could not trace some items from the physical locations back to the listings.

A number of departments did not prepare monthly equipment reconciliations as required by the State Administrative Manual. Also, a number of departments have not conducted a physical count of equipment within the last three years. Although five agencies performed the physical inventory, they did not adjust the general ledger for the differences between the physical count and their inventory listing. Finally, a number of departments do not adequately separate the duties over equipment inventory and the maintenance of equipment records.

Table 1 below lists the departments we tested during fiscal year 1994-95. It shows the number of items tested for additions, deletions, and inventory tracing and the number of items we found that did not comply with State Administrative Manual requirements. The table shows that 8 out of 21 agencies did not complete the required periodic reconciliation, 4 did not perform physical inventory counts, and 6 had inadequate separation of duties. The State Administrative Manual, Section 8600 et seq., defines equipment and provides guidelines for state agencies to follow in accounting for and controlling equipment, including conducting physical inventories and having adequate separation of duties. In addition, Section 7969 requires agencies to reconcile the equipment expenditures to the property ledger monthly, or quarterly if the volume of property transactions is small.

Table 1

**Deficiencies in Accounting for and Controlling
State Equipment at Various Agencies
Fiscal Year 1994-95**

Agency Name	Additions		Deletions		Inventory Tracing				Reconciliation Not Prepared Monthly or Quarterly	No Physical Inventory in Last Three Years	Inadequate Separation of Duties
	Number Tested	Not Recorded Correctly in General Ledger or Inventory	Number Tested	Not Correctly Authorized	Number Tested	Item Not Located in Field	Number Tested	Item Not on Inventory Listing			
Department of Justice	10		10		5		5				
State Controller's Office			10	1	5		5	1			
Franchise Tax Board	10				5	1	5				
Department of Housing and Community Development	10		10		5		5		X		
Department of Insurance	10	7			5	1	5		X		X
Department of Transportation (4 districts)	20		7	3	17	7	20	6			X
California Highway Patrol	10		10		5		5				
Department of Motor Vehicles	10				5	2	5	1			
Department of Forestry and Fire Protection	10	7			5		5		X	X	
Department of Fish and Game	10				5		5		X	X	
Department of Parks and Recreation			10		5	1	5		X	X	X
Department of Water Resources					5		5			X	
Department of Pesticide Regulation	10	1			5		5				X
Department of Health Services			10		5		5				
State Water Resources Control Board	10	4	10	1	5		5				
Employment Development Department	10				5	3	5		X		
Department of Social Services	10		10		5	1	5		X		
Department of Corrections	10		10		10		10		X		
CSU Northridge			10		5		5	1			
CSU Stanislaus	10	4	10	1	5		5		X		X
Department of Industrial Relations					5		5	1	X		X
Total	160	23	117	6	122	16	125	10	8	4	6

State and Federal Compliance Issues

The remaining statewide concerns are state or federal compliance problems. Generally, the issues relate to the lack of guidance in the State Administrative Manual and the State's failure to ensure that departments comply with existing state and federal requirements.

The Statewide Real Property Inventory Is Incomplete

The State has inadequate procedures to ensure that the Department of General Services' (DGS) Statewide Real Property Inventory incorporates all real property transactions as recorded in state agency accounting records. Specifically, state agencies are not required to reconcile the amount reported in the Statewide Real Property Inventory to their Statement of Changes in General Fixed Assets. While the agencies' accounting offices prepare the Statement of Changes in General Fixed Assets and submit it to the SCO for inclusion in financial statements, other offices in the state agencies are responsible for reporting cost information related to their land and buildings to the DGS's Office of Real Estate and Design Services (OREDS). Unless the agencies reconcile the cost information in the two documents, the State may not maintain a complete and accurate inventory of all its real property. Errors and discrepancies could occur and remain undetected. Also, the amounts reported for inclusion in the State's financial statements will not agree with the Statewide Real Property Inventory.

State law requires the DGS to maintain a complete and accurate inventory of all real property held by the State. State law also requires each agency to furnish the DGS with a record of each parcel of real property that it possesses and to update its real property holdings, reflecting any changes, by July 1 each year. State policy requires agencies to report all additions and improvements to real property that are funded from major capital outlay appropriations.

Procedures for Federal Programs Are Deficient in Cash Management

The State needs to improve its management of cash received for the administration of federal programs. We reviewed the cash management procedures for 57 federal programs at 24 departments and found numerous instances of noncompliance with federal laws and regulations. Specifically, we determined that there were errors in calculating the cash management interest liability and that departments made untimely transfers of federal monies and inadequately monitored cash advances made to subrecipients.

***Cash Management Implementation Issues
Have Created Errors in Calculating
Interest Liability***

The Cash Management Improvement Act (CMIA) of 1990 required the State and the Financial Management Service, U.S. Department of the Treasury (federal government), to enter into a CMIA agreement for fiscal year 1994-95. The agreement would establish procedures for ensuring greater equity, efficiency, and effectiveness in the exchange of funds between the State and the federal government. The agreement would also establish the procedures for calculating the interest liability that results from the timing of the exchange of funds between the State and federal government for applicable major federal program expenditures. However, the State and the federal government could not agree on all of the procedures to implement the requirements of CMIA for fiscal year 1994-95. Therefore, in lieu of an agreement, the federal government issued CMIA Default Procedures (default procedures) for the State to follow to implement CMIA for fiscal year 1994-95. In some instances, however, the State could not always comply with the default procedures because the State's systems for requesting and disbursing federal funds do not accommodate the requirements of the default procedures. In other instances, the State could not comply with certain portions of the default procedures because the federal funds requested were not available to the State when it paid the federal program expenditures. In addition, the State did not comply with certain portions of the default procedures because it does not believe that these procedures provide equity in the exchange of funds between the State and federal government and the calculation of the interest liability.

Because the State did not always comply with the default procedures when implementing CMIA for fiscal year 1994-95, the interest liability that the State calculated and reported to the federal government for the fiscal year was not always in accordance with the default procedures. The net effect of the State's noncompliance with the default procedures is an understatement totaling approximately \$3.0 million in interest liabilities for applicable CMIA programs.

The default procedures required the State to track and calculate the state and federal interest liabilities for the major federal programs affected by CMIA. However, there are a few exceptions to this requirement. One of the exceptions is the Supplemental Security Income program in which the federal government performs the interest liability calculation, rather than the State. In addition, several major federal programs are exempt from the interest liability calculation. The default procedures also assigned the Department of Finance (DOF) the responsibility for implementing the procedures for tracking and calculating the state and federal interest liabilities for the major federal programs. In addition, the DOF is responsible for reporting the interest liability to the federal government in the CMIA Annual Report.

Departments that administered federal programs that were not exempt from the interest liability submitted information to the DOF on the transfer of funds between the State and the federal government. Specifically, the departments provided to the DOF the number of interest days, which is either the number of days from the deposit of federal funds in a state account to warrant issuance or the number of days from warrant issuance to the deposit of federal funds. In addition, the departments provided to the DOF the amount of federal funds deposited in the State's account for program expenditures. The DOF used

this information to calculate the interest liability. We identified errors in the information reported to the DOF and used in the interest liability calculation that resulted in a \$29,000 underpayment of state interest liability. For the Highway Planning and Construction and the Federal Family Education Loan programs, the California Department of Transportation and the Student Aid Commission calculated and reported the interest liabilities to the DOF.

As previously discussed, the State could not always comply with the default procedures because the State's systems for requesting and disbursing federal funds do not accommodate the requirements of the default procedures. For example, according to the Department of Finance, the Department of Health Services was unable to obtain timely information from the State's accounting system and was unable to make a weekly estimate of federal expenditures for the Maternal and Child Health Services Block Grant and request the funds from the federal government in advance of the expenditures, even though this was required in the default procedures. Therefore, the State advanced its own funds to pay federal program expenditures for this program, and the federal government reimbursed the State. However, the State could not calculate an interest liability for the program, even though it would be equitable for the State to do so since it advanced its own funds. Additional instances in which the State could not comply with the default procedures occurred because the federal funds requested were not available to the State when it paid the federal program expenditures. For example, the federal funds were not available to pay program expenditures for the Family Support Payments to States—Assistance Payments and the Crime Victim Compensation programs. As a result, the State used its funds to pay program expenditures and calculated a federal interest liability totaling approximately \$2.5 million and \$446,000, respectively, for the two programs. Generally, whenever the State used its funds to pay federal program expenditures and received reimbursement from the federal government at a later date, the State calculated and reported a federal interest liability.

Furthermore, the State did not always comply with the default procedures because the State and the federal government do not agree on certain provisions of the default procedures. In one instance, the State calculated and reported a federal interest liability on expenditures that according to the default procedures were exempt from the interest liability. In another instance, the State did not always include the required expenditures in the net interest liability calculation. Furthermore, the State used redemption patterns in the interest liability calculation that did not always comply with the default procedures. The redemption patterns represent the average time from when a warrant is issued to the time the same warrant is redeemed. The DOF uses this information in the interest liability calculation. Finally, the State offset the state interest liability by the direct cost of implementing CMIA. When we discussed these instances of noncompliance with the DOF, the DOF stated that the procedures they used to implement and calculate the interest liability may not always comply with the default procedures. However, in the opinion of the DOF, the State's procedures are equitable when considering the intent of CMIA, the processes used by the State to pay federal program expenditures, the timing of the transfer of funds between the State and the federal government, and the average redemption time of warrants issued by the State.

The following is a more complete discussion of the State's noncompliance with the default procedures and their affect on the interest liability calculated and reported to the federal government:

- The DOF included in the CMIA Annual Report a federal interest liability for a program that was exempt from the liability calculation according to the default procedures. Specifically, the Student Aid Commission calculated a federal interest liability totaling approximately \$2 million for the Federal Family Education Loan Program that the DOF included in the CMIA Annual Report. However, the DOF was in error when it agreed that state funds were used to purchase defaulted student loans that result in a federal interest liability. The DOF now agrees that state funds were not used to purchase defaulted student loans. Therefore, a federal interest liability should not be calculated. Because the State reduces its interest liability by any federal interest liability, the effect of including the federal interest liability in the CMIA Annual Report was a net understatement by the State of approximately \$2 million. However, the State plans to refund the federal government the \$2 million interest amount in June 1996.
- The DOF did not include in the CMIA Annual Report approximately \$577,400 of state interest liability it calculated for federal funds advanced to the State for payroll expenditures. The default procedures require the State to track and calculate the interest liability resulting from federal funds advanced to the State for applicable payroll expenditures. Even though the DOF required the departments to track and report the advance payroll expenditure information, and the DOF calculated the resulting interest liability, the DOF did not include the amount in the CMIA Annual Report submitted to the federal government. The DOF did not include the advance payroll interest liability in the annual report because the DOF felt it would not be equitable because the interest liability that should accrue when the State uses its own funds to cover payroll and operating costs for applicable federal programs is not included in the CMIA Annual Report. More specifically, the payroll and operating expenditures that are initially paid by the State and later reimbursed by the federal government are not tracked and included in the interest liability calculation. Furthermore, if the State could track and calculate the interest liability resulting from these payroll and operating expenditures, the federal government would owe the State.

Because the departments tracked the advance payroll expenditure information and the DOF performed the interest liability calculation from the information, we reviewed both the advance payroll information at the departments and DOF's calculation of the interest liability. The cumulative effect of minor errors in the payroll information at the departments and the DOF's omission of the interest liability resulting from advance payroll expenditures is an understatement of the State's interest liability by approximately \$577,500.

- The State used redemption patterns in the interest liability calculation that did not always comply with the default procedures. The redemption patterns represent the average time from the date a warrant is issued to the date the warrant is redeemed. Specifically, the State used redemption patterns that were generally fewer days than those specified in the default procedures for 17 programs. As a result, the interest liability calculated was understated by approximately \$228,800. Once again, the DOF did not comply with the default procedures.

- The Code of Federal Regulations, Title 31, Section 205.14(b)(1), does not allow the State to offset its interest liability by the direct cost of implementing CMIA when the State is using default procedures. However, the State did offset the interest liability by the direct cost, resulting in an understatement totaling approximately \$190,200.

In addition to the problems discussed above, we identified minor errors in the DOF's calculation of the interest liability that caused an underpayment totaling approximately \$14,000. Specifically, for one program, the DOF did not use the correct amount of funds transferred in its calculation, causing an understatement in the amount of interest the State would owe the federal government. For another program, the DOF did not carry forward into its summary reports the correct number of days the federal funds were in the state treasury before a warrant was issued, causing another understatement of the State's interest liability. For both programs, the DOF used redemption patterns that did not comply with the default procedures as discussed above.

For 30 of the 43 programs we audited, we also found errors in the information reported to the DOF by the departments and used in the interest liability calculation. Specifically, departments did not always correctly report the amount of funds transferred and/or the number of days the federal funds were in the state treasury before warrant issuance. These errors resulted in an underpayment in the State's interest liability totaling approximately \$29,000. In total, the State underpaid its interest liability by approximately \$43,000 because of the errors identified above. In addition, because the State did not always comply with the default procedures, it also understated its interest liability by an additional \$3.0 million.

The State paid approximately \$8.6 million in interest liabilities related to the fiscal year 1994-95 CMIA. However, this payment does not take into account the issues and errors that have been discussed in this section of our report.

Until the State and the federal government can agree on CMIA procedures that are equitable to all parties involved, the State's interest liability calculation and payment will contain noncompliance issues. As of June 5, 1996, the State and the federal government have not agreed on the CMIA procedures that the State will use to implement CMIA in fiscal year 1995-96.

Departments Do Not Promptly Request the Transfer of Federal Funds

The State does not promptly request federal funds for expenditures initially paid from the General Fund, nor does it promptly reimburse the federal government for excess funds it has received. When it does not promptly request reimbursement, the State loses potential interest earnings. In contrast, when it does not promptly repay excess federal monies, it may incur an interest liability to the federal government. We found the following examples of delays in the transferring of federal funds:

- The Department of Health Services did not promptly obtain reimbursement from the federal government for the Refugee and Entrant Assistance-State Administered Programs and the Maternal and Child Health Services Block Grant. These delays in obtaining reimbursement resulted in a loss of potential interest earnings to the State of \$113,000 and \$110,000, respectively.
- The Department of Social Services underestimated its cash needs by \$5.67 million for 16 drawdowns of federal monies that we reviewed, resulting in lost interest earnings to the State of \$25,200. Conversely, for 2 other drawdowns reviewed, the department overestimated its cash needs by \$2.69 million, resulting in \$28,700 in interest earned by the State to which it was not entitled.
- The State lost interest earnings of approximately \$13,000 because the Department of Justice did not submit billings to the Department of Social Services until seven months after the Department of Justice started providing services under the Child Support Enforcement Grant program. The Department of Social Services does not collect federal monies for this program until it receives billings from the Department of Justice.

Federal regulations require the State to minimize the time between the transfer of funds from the U.S. Treasury and the payment of expenditures, as well as to limit its requests for federal funds to the minimum required to meet the State's immediate needs.

The State Does Not Adequately Monitor Advances to Subrecipients

The State does not always limit cash advances made to subrecipients to their immediate needs. We found that the State made cash advances in excess of immediate needs for six federal programs at five departments. These deficiencies occurred because the State did not adequately monitor the cash balances of the subrecipients. Table 5, beginning on page 252, lists the federal programs for which we found such deficiencies. We found the following examples of inadequate monitoring of advances:

- The California Community Colleges, Chancellor's Office (Chancellor's Office), did not ensure that cash advances to subrecipients participating in the Vocational Education—Basic Grants to States program were only provided to meet immediate needs. We reviewed 30 payments made to subrecipients and found that the Chancellor's Office issued to ten subrecipients funds totaling \$318,000 more than their immediate needs.
- The Department of Alcohol and Drug Programs did not have adequate procedures to monitor the cash balances of subrecipients of the Substance Abuse Prevention and Treatment Block Grant and the Safe and Drug-Free Schools—State Grants. We reviewed quarterly federal cash transaction reports for 12 counties and found 2 reported cash balances that would last more than 30 days. Further, the department did not adjust subsequent monthly advances for either of these counties.

- The Department of Community Services and Development made cash advances to 3 of the 24 subrecipients we reviewed for the Community Services Block Grant, even though these subrecipients maintained excessive cash balances for three quarters during fiscal year 1994-95.

Without adequate monitoring of subrecipient cash balances, the State cannot ensure that advances are limited to immediate needs.

The State Has Not Adequately Recorded Expenditures and Receipts for Each Federal Program

The State has not complied with a provision of the Office of Management and Budget (OMB), Circular A-128 (Circular A-128), requiring a schedule that shows total expenditures for each federal assistance program. Circular A-128 requires the State to identify all federal grants from which it expends more than \$20 million in a single year. The State cannot comply because it does not report its expenditures by federal program due to limitations in its automated accounting systems. The California Government Code, Section 13300, assigns the DOF the responsibility for establishing and supervising a complete accounting system to ensure that all revenues, expenditures, receipts, disbursements, resources, obligations, and property of the State are properly accounted for and reported. Thus, the schedule of federal assistance that we present, beginning on page 227, shows total receipts by program, rather than expenditures.

The State also does not have centralized records for recording the receipt of federal monies, potentially resulting in an impairment of its ability to satisfy federal requirements. In 1978, the State took steps to establish a centralized record of federal receipts. In that year, it created the Federal Trust Fund for the deposit of all federal monies received and administered through or under the direction of any state agency. This fund was created to provide better accountability for the State's receipts and expenditures of federal funds. If the State consistently required that all federal receipts be recorded in the Federal Trust Fund, the centralized records would help satisfy requirements under Circular A-128. However, the State has allowed some federal receipts not to be recorded in the Federal Trust Fund. For example, in 1991, Section 89049.1 of the Education Code was added to allow the Federal Trust Fund to be bypassed for receipts for student financial aid at California State University. During fiscal year 1994-95, these receipts totaled more than \$545 million. In addition, the DOF administratively created the State Legalization Impact Assistance Fund to account for receipts and expenditures from the federal State Legalization Impact Assistance Grants, again bypassing the Federal Trust Fund. These receipts totaled more than \$2.3 billion for fiscal years 1988-89 through 1994-95.

The absence of centralized records results in additional work to prepare the schedule of federal assistance required by Circular A-128. For example, to determine fiscal year 1994-95 receipts, the State had to request that California State University identify receipts for student financial aid grants separately. Furthermore, the potential exists that the State will fail to identify all receipts. This lack of identification could result in material misstatements in the schedule of federal assistance or the failure to identify all grants requiring an audit under Circular A-128.

Circular A-128 requires the State to submit an audit report on a schedule of federal assistance that shows the total expenditures for each federal assistance program.

We have previously reported this issue. The DOF has responded that making the necessary modifications to the State's automated systems would require extensive effort.

The State Does Not Sufficiently Monitor Recipients of State and Federal Monies

The State is often deficient in its monitoring of recipients of state and federal monies. We found the administration of more than 24 federal and 2 state programs in 13 departments deficient in a wide variety of required monitoring practices. Specifically, we determined that departments did not conduct audits or reviews of recipients' operations or records, or they did not ensure that subrecipients submit audit reports completed by independent auditors. Table 5, beginning on page 252, lists the federal programs for which we found such deficiencies. We found the following examples of deficient monitoring:

- The Office of Public School Construction (OPSC) has not finalized close-out audits on approximately 723 completed school construction projects, even though 174 of these projects have been complete for at least four years. Without these audits, the OPSC can neither determine the amount of the projects' allowable expenditures nor whether the State owes school districts additional funds. Further, the OPSC cannot determine whether any funds that may have been apportioned for these projects in excess of actual costs are to be returned to the State and made available for other projects.
- The Department of Health Services was unable to provide us with 40 of the 76 audit reports that should have been submitted to the department by nonprofit subrecipients participating in the Maternal and Child Health Services Block Grant and the HIV Care Formula Grants programs. The department had not included 33 of these 40 nonprofit subrecipients on the database it uses to monitor the receipt of required reports. Without the audit reports and a comprehensive database to track subrecipients, the department lacks assurance that subrecipients are complying with federal laws and regulations.
- The Department of Aging did not perform required biennial on-site reviews of supportive and nutrition services for 3 of the 33 area agencies on aging for the Special Programs for the Aging—Title III, Part B and Part C grants. Of the 30 on-site reviews that the department performed, 12 were for nutrition services only and did not include assessments for supportive services. Failure to conduct thorough evaluations may prevent early detection and correction of deficiencies in the services provided by the area agencies.
- The Chancellor's Office did not review 51 of the 71 audit reports from the State's community college districts for fiscal year 1994-95. Because the Chancellor's Office is not properly monitoring audit reports, it cannot ensure that community college districts promptly and appropriately resolve instances of noncompliance with federal and state laws and regulations.

- The Department of Social Services' process to monitor nonprofit subrecipients for compliance with federal audit reporting requirements needs improvement. Our review of the department's process for monitoring 18 nonprofit organizations for five federal programs disclosed that, among other deficiencies, it had no formal procedures for reviewing required independent audit reports and did not always obtain information from independent auditors regarding instances of noncompliance with federal laws or regulations. Without an adequate review process, the department lacks assurance that the subrecipients are complying with federal laws and regulations and that federal money is being spent appropriately.

Administration of State Contracts and Interagency Agreements

In addition to our annual financial and compliance audit, we also reviewed the State's administration of contracts and interagency agreements. The results of our review will be issued in August 1996 (Report No. 95015). The report will address the State's compliance with laws and regulations related to contracts and interagency agreements and adherence to policies and procedures for sound contract management.

Significant Departmental Concerns

In addition to the statewide concerns, individual departments have significant weaknesses that should be addressed by the Department of Finance (DOF) and the applicable departments. While not systemic in nature, these weaknesses, some of which are material, represent deviations from laws, regulations, and internal controls. We found the following examples of significant weaknesses at individual departments:

The Department of Community Services and Development Improperly Charged Federal Program Costs

The Department of Community Services and Development (department), formerly the Department of Economic Opportunity, inappropriately charged to the previous year's grant costs incurred in the following year for the administration of a federal grant. Specifically, the department inappropriately made adjusting entries to its accounting records to transfer costs originally charged to federal fiscal years 1990 through 1994 back to federal fiscal years 1989 through 1993, respectively, for its Community Services Block Grant (CSBG). The department transferred amounts ranging between \$500 from federal fiscal year 1990 to 1989 and \$696,700 from federal fiscal year 1994 to 1993.

To cover its costs for administering the CSBG program, each year the department is allowed to spend 5 percent of the total grant on administrative costs. However, between fiscal years 1989 and 1993, the department did not spend up to the 5 percent limit. It recovered these funds by transferring expenditures from one grant year to the previous grant year, making adjusting entries to its accounting records.

The department also directed some of its employees to charge their time to a specific federal program even though the employees had not worked on that program. For June 1995, employee time totaling \$114,000 was charged to the Earthquake Disaster Assistance program even though the employees had not worked on this federal program. According to the department, it undercharged the Earthquake Disaster Assistance program during fiscal year 1993-94 when employees actually worked on that program. At the time, the department had not established a cost center so that employees could charge time to the program. In 1993-94, the employees charged the time worked on the Earthquake Disaster Assistance program to other federal programs.

In July 1995, we discussed this issue with the department, and it agreed to take steps to correct the errors. The department provided us with a schedule of employees who had worked on the Earthquake Disaster Assistance program during fiscal year 1993-94. The schedule summarized the program initially charged, hours worked, salary and benefits, and travel expenses. However, the department only documented \$65,000 of the \$114,000. We also found that the schedule was incomplete and inaccurate. Furthermore, the department did not correct its accounting records for the errors. Unless the department adjusts its records for the actual costs incurred, federal programs may not

pay their fair share of costs. United States Code Annotated, Title 42, Section 9907(b), states that funds for a fiscal year allotment must be expended in the same or succeeding fiscal year. The Office of Management and Budget (OMB) "Common Rule" requires states to account for grant funds to permit the tracing of funds to a level of expenditures adequate to determine the appropriate use of funds.

The Board of Equalization Lacked a Policy for Penalty Assessment on Underpayment of Required Fees

The Board of Equalization (board) lacked a policy of assessing penalties for underpayment of required fuel tax prepayments and, thus, it did not assess penalties of at least \$34,800. We reviewed 56 monthly prepayments made during fiscal year 1994-95 by 14 motor vehicle fuel distributors. Distributors underpaid the required amount in three instances. In one instance, although the board detected an underpayment of \$429,000, it did not assess a penalty. In two other instances, the board did not detect underpayments of \$149,700 due to an error it made in calculating the required prepayment. Although the amount of penalties not assessed by the board in our sample is small, the effect could be much greater when applied to all of the required fuel tax prepayments made during each fiscal year.

We reported a similar finding during our financial audit for fiscal year 1991-92. At that time, the senior auditor of the fuel taxes division stated that there was no provision in law to assess penalties on the underpayment of required taxes. However, because we brought this problem to the board's attention during fiscal year 1994-95, the board now plans to assess penalties for underpayment of required fuel tax prepayments, thus providing the State with an additional revenue source.

Section 7659.1 of the Revenue and Taxation Code requires fuel distributors whose estimated tax liability averages \$900,000 or more per month to make a prepayment of taxes each month. Section 7659.5 requires that those fuel distributors who fail to make a timely prepayment must pay a penalty of 6 percent of the prepayment amount. Section 7659.7(b) requires that, if any part of the deficiency in prepayment is due to negligence or intentional disregard of the regulations, the fuel distributors must pay a penalty of 10 percent of the deficiency.

The Department of Housing and Community Development Needs To Improve Its Control Over Housing Loans

The Department of Housing and Community Development (department) needs to improve its control over loans distributed from its housing funds. In our audit for fiscal year 1993-94, we reported that the department could not reconcile a difference of \$25.4 million between its accounting records and program records for its housing funds. In response to our prior audit, the department hired an independent CPA firm to reconcile its accounting and program records through June 30, 1995. The CPA firm proposed adjustments to the accounting records totaling \$17.6 million. Further, the CPA firm

developed procedures for the department to prepare monthly reconciliations of accounting and program records. However, as of April 1996, the department has not performed any reconciliations of accounting and program records for fiscal year 1995-96 loan receivable activity.

Because the department is not performing reconciliations intended to detect errors or omissions in its housing loans records, it cannot provide effective accounting control over housing loans, which in turn protect the public's resources from abuse.

The Stephen P. Teale Data Center Did Not Fully Recover Some Service Costs

During fiscal year 1993-94, the Stephen P. Teale Data Center (data center) entered into an interagency agreement with the Department of Motor Vehicles (DMV) to provide computing services over a five-year period for a project called Network 2000. To facilitate this agreement, the data center added a new rate to its published rate schedule and billed the DMV for services based on the number of transactions the DMV processed each month. This billing procedure differs from the data center's standard procedure of billing customers for actual system services used and for any equipment used exclusively for that customer. Because it billed the DMV for the number of transactions processed instead of using the data center's existing rates, by June 30, 1995, the data center had incurred costs that exceeded the billings it made to the DMV by more than \$3.1 million.

According to the assistant director of administration and finance, to meet the needs of its agreement with the DMV, the data center had to purchase equipment during the start-up phase of the project. He also stated that the data center is using surpluses it has accumulated over the past few years to finance these start-up costs. However, because the data center is required to operate on a break-even basis, it should return any surpluses from past years to its customers by lowering its service rates. If the data center had used its standard procedures for billing customers and its current rates in its agreement with the DMV, it would have recovered the start-up costs for the project. Although the data center did reduce its billing rates for fiscal years 1994-95 and 1995-96, it could have reduced them even further had it recovered its costs for the DMV project. By using the surpluses from past years to recover a portion of the costs of the DMV project, the data center is actually charging those costs to other state agencies. Moreover, because some of the other state agencies receive federal funds to pay for services provided by the data center, the federal government may also be subsidizing the DMV project.

The State Administrative Manual, Section 4982.2, requires the data center to operate on a break-even basis each fiscal year. In addition, the section requires the data center to charge its users for units of service according to a published service rate schedule. Finally, Section 8752 requires the data center to recover its full costs whenever it provides goods or service to others.

The Office of State Printing Inappropriately Allocated Legislative Costs to the Federal Government

The Department of General Services' Office of State Printing (OSP) inappropriately charged a portion of legislative printing costs to the federal government. As part of the printing services it provides to the State, the OSP prints a variety of legislative documents. Costs related to producing these documents are budgeted and funded by the Legislature each fiscal year. In fiscal years 1993-94 and 1994-95, the cost of legislative printing exceeded the funding provided by the Legislature by \$299,000 and \$212,000, respectively. These costs were passed on to state agencies through higher rates charged for all other printing services. Because state agencies pay for printing services with federal funds, a portion of these costs were paid with federal funds. OMB Circular A-87 specifically excludes general government and legislative expenses from the list of allowable federal program costs.

The Department of Health Services Did Not Always Prepare Accurate Financial Statements

The Department of Health Services (department) did not accurately prepare its financial reports for fiscal year 1994-95 for its Health Care Deposit Fund, General Fund, and Federal Trust Fund. During our audit, we noted the following conditions:

- The department overstated its Medi-Cal accrual by \$703 million at June 30, 1995, because it did not adjust prior-year accruals to reflect current projections for Medi-Cal costs. As a result, the department overstated receivable and liability accounts for the Health Care Deposit Fund and the Federal Trust Fund, and liability accounts for the General Fund.
- The department posted an accrual twice and, as a result, overstated its due from other funds and due to other governments accounts by approximately \$180 million in the Health Care Deposit Fund. The error of \$180 million resulted in the overstatement of receivable and liability accounts in the department's Federal Trust Fund.
- The department did not ensure that all amounts for the AIDS Drug Assistance Program were accrued in the General Fund. While it correctly accrued the federally funded portion of the accounts payable, it overlooked the accrual for the State's portion of the program. As a result, the department understated its accounts payable and expenditure accounts in the General Fund by approximately \$6.8 million.

Confusion Exists Over Requirements for Approval for Some Contracts

The State Administrative Manual does not provide adequate guidance about which agreements for services require the approval of the Department of General Services (DGS). The Public Contract Code, Section 10295, states that all contracts entered into by

any state agency for services are void unless and until approved by the DGS. The Health and Safety Code, Section 38012, requires DGS approval of direct service contracts entered into by departments in the Health and Welfare Agency. The Attorney General's Office issued two opinions, one in 1975 and one in 1980, that precede the effective date of the direct service contract legislation. The opinions distinguish grants from contracts, and they state that certain grants are not contracts for services and therefore are not subject to the DGS's review and approval.

Some departments have relied on the opinions of the Attorney General's Office as their rationale for not obtaining DGS approval of agreements for services. For example, the Office of the Auditor General reported in 1989 that the Department of Health Services did not always obtain DGS approval of contracts when it was required. The department, which is in the Health and Welfare Agency, responded that it considered the contracts in question to be grants, basing its position on the opinions of 1975 and 1980. However, a more recent opinion of the legislative counsel, obtained during the Office of the Auditor General's 1989 audit, determined that some of these contracts did not meet the legal definition of a grant.

In our current review of similar contracts at the department, we found that it continues to cite the opinions of the Attorney General's Office in classifying Indian Health Program contracts as grants, even though the legislative counsel concluded that an agreement for this program was a direct services contract and therefore subject to DGS review and approval. During fiscal year 1994-95, the Department of Health Services entered into approximately \$2.4 million in agreements for the Indian Health Program.

The DGS provides an independent review of contracts to ensure that state agencies are complying with laws and regulations and that the financial interests of the State are preserved and protected. If a department incorrectly classifies a contract as a grant, the State's system of controls is circumvented, and the State has less assurance that its financial interests are being protected.

Legislation introduced in February 1996 would require that the DGS review and approve all grants and contracts. However, as of May 1996, this legislation had not been enacted. In addition, the State Administrative Manual may be amended to include the requirement that grants be reviewed by the DGS.

Alcohol and Drug Program Administrative Costs Charged to a Federal Grant Exceeded The Allowable Amount

The Department of Alcohol and Drug Programs (department) spent approximately \$721,000 in federal funds to administer the Safe and Drug-Free Schools grant in fiscal year 1994-95, exceeding allowable administrative costs for the grant by approximately \$360,000. The department did not compare actual administrative expenditures to budgeted expenditures during the year so that it could limit charges to the budgeted amounts. Although the department limited its budgeted administrative costs to the 2.5 percent allowed by the United States Code, the actual administrative costs

charged to the grant exceeded 5 percent. Failure to limit state administrative costs to 2.5 percent of the grant amount could result in the reduction of future federal grant monies.

Recommendations

The State should revise its practices to improve weaknesses in its accounting and administrative controls. Specifically, the DOF should do the following:

- Ensure that the State's budget and accounting systems are able to efficiently record and report its financial operations in a manner that is as consistent with generally accepted accounting principles as possible;
- Ensure that agencies comply with existing State Administrative Manual requirements relating to fixed assets and contracting and interagency agreement procedures;
- Ensure that agencies fully comply with federal requirements related to federal grant monies received;
- Ensure that agencies reconcile the information contained in the statewide real property inventory to the information contained in their year-end Statement of Changes in General Fixed Assets; and
- Revise the State Administrative Manual to provide guidance on the appropriate use of grants.

Audit Information by Area of Government

The State of California continues to incur unnecessary costs and faces reduced efficiency and effectiveness in its operations because of weaknesses in its internal control structure. Although it has corrected many of the problems the Bureau of State Audits reported in prior years, the State can still significantly improve its accounting and administrative controls.

Table 3 summarizes state expenditures and the financial and compliance audit activity of the Bureau of State Audits during fiscal year 1994-95. Other audits issued by the Bureau of State Audits are summarized in the final column of the table and cover the period from July 1, 1994, through December 31, 1995. The table organizes this information according to the areas of government recognized in the Governor's Budget. The Bureau of State Audits conducted financial and compliance audit work in nine areas of government. The Education and the Health and Welfare areas together have expenditures that represent more than 76 percent of the State's total expenditures, and these two areas receive monies from 47 major federal grant programs.

Table 3

**Summary of Audit Work by Area of Government
Fiscal Year 1994-95**

Area of Government	Total Amount/ Percent of State Expenditures*	Number of Departments			Amount/Number of Federal Grants Audited	Number of Special Topic Reports (7/1/94 to 12/31/95)
		In Area of Government	Amount and Number of Departments Audited*	With Reported Weaknesses		
Business, Transportation and Housing	\$6.9 billion 6.0%	17	\$6.5 billion 6	5	\$1.732 billion 4	9
Education	\$43.9 billion 38.7%	15	\$32.6 billion 5	5	\$2.542 billion 14	7
Environmental Protection	\$0.7 billion .6%	6	\$0.4 billion 1	0	\$105 million 1	1
General Government	\$8.4 billion 7.1%	55	\$0.3 billion 4	3	\$65 million 2	3
Health and Welfare	\$43.3 billion 38.2%	20	\$40.8 billion 10	10	\$20.099 billion 33	11
Legislative, Judicial and Executive	\$3 billion 2.7%	39	\$2 billion 6	5	\$1.095 billion 3	5
Resources	\$2.3 billion 2.0%	24	\$1 billion 3	0	0	6
State and Consumer Services	\$1.5 billion 1.3%	11	\$ 0.9 billion 2	2	0	6
Youth and Adult Correctional	\$3.9 billion 3.4%	5	\$3.8 billion 2	2	0	3

* Amounts reported in these columns are total estimated expenditures for all state departments in the agency or for all departments audited during fiscal year 1994-95. Estimated amounts are from the Governor's Budget for fiscal year 1996-97. The estimates do not reflect actual amounts audited.

This report summarizes the results of the financial and compliance audit work that the Bureau of State Audits conducted for fiscal year 1994-95. The Bureau of State Audits reports the results of these audits in management letters addressed to the administrators of each of the departments that include audit issues. These management letters are included in this report, beginning on page 35.

Table 4 shows the distribution by state department of weaknesses in control over financial activities and weaknesses in compliance with state and federal regulations. The page number column in the table provides the location in this report of the beginning of the specific management letter for the indicated department. The numbers in the other columns represent the number of occurrences for that classification as reported in the management letters for the departments. A more detailed table describing the type of weaknesses found in compliance with federal regulations begins on page 252.

TABLE 4

WEAKNESSES IN INTERNAL CONTROL SYSTEMS

Agency	Page Number	Number of Weaknesses				
		Financial Reporting Activities	Revenue Activities/ Safeguarding of Assets	Expenditure and Electronic Data Processing Activities	Compliance With Federal Regulations	Compliance With State Regulations
BUSINESS, TRANSPORTATION AND HOUSING						
Housing and Community Development, Department of	43	2	4	3	17	6
Motor Vehicles, Department of	56	1	2	1		3
Stephen P. Teale Data Center	59	2	4	2		8
Transportation, Department of	63	1			1	1
EDUCATION						
California Community Colleges, Chancellor's Office	67	4	1	5	7	5
California Postsecondary Education Commission	94				1	
California State University, Chancellor's Office	78	3				3
California Student Aid Commission	96				2	
Education, California Department of	99	2		2	7	4

Agency	Page Number	Number of Weaknesses				
		Financial Reporting Activities	Revenue Activities/ Safeguarding of Assets	Expenditure and Electronic Data Processing Activities	Compliance With Federal Regulations	Compliance With State Regulations
GENERAL GOVERNMENT						
Community Services and Development, Department of	111				14	1
Criminal Justice Planning, Office of	118			3	14	
Finance, Department of	129					2
HEALTH AND WELFARE						
Aging, Department of	139				1	
Alcohol and Drug Programs, Department of	141				10	
Developmental Services, Department of	148				4	1
Employment Development Department	153				5	
Health and Welfare Agency Data Center	157	5	2	1		8
Health Services, Department of	161	6	3	5	8	16
Rehabilitation, Department of	173				6	
Social Services, Department of	175	4	1	1	13	
LEGISLATIVE, JUDICIAL, AND EXECUTIVE						
Emergency Services, Office of	187	3	1	2	5	5
Insurance, Department of	196	1				1

Agency	Page Number	Number of Weaknesses				
		Financial Reporting Activities	Revenue Activities/ Safeguarding of Assets	Expenditure and Electronic Data Processing Activities	Compliance With Federal Regulations	Compliance With State Regulations
Justice, Department of	198		1	2	1	1
Board of Equalization	194		1			1
STATE AND CONSUMER SERVICES						
Franchise Tax Board	203	1	1			
General Services, Department of	205	2	2	1	1	5
YOUTH AND ADULT CORRECTIONAL						
Corrections, Department of	213	1				1
Youth Authority, Department of the	215				2	

Report on the Internal Control Structure

Independent Auditors' Report on the Internal Control Structure

The Governor and Legislature of
the State of California

We have audited the general purpose financial statements of the State of California as of and for the year ended June 30, 1995, and have issued our report thereon dated December 15, 1995. We did not audit the financial statements of the pension trust funds, which reflect total assets constituting 81 percent of the fiduciary funds. We also did not audit the financial statements of certain enterprise funds, which reflect total assets and revenues, constituting 87 percent and 91 percent, respectively, of the enterprise funds. In addition, we did not audit the University of California funds. Finally, we did not audit the financial statements of certain component unit authorities, which reflect total assets and revenues, constituting 97 percent and 95 percent, respectively, of the component unit authorities. The financial statements of the pension trust funds, certain enterprise funds, the University of California fund, and certain component unit authorities referred to above were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for these funds and entities is based solely upon the reports of other independent auditors. We have also audited the State of California's compliance with requirements applicable to major federal financial assistance programs and have issued our report thereon dated April 15, 1996.

We conducted our audits in accordance with generally accepted auditing standards; *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Circular A-128, *Audits of State and Local Governments*. Those standards and OMB Circular A-128 require that we plan and perform the audit to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement and about whether the State of California complied with laws and regulations, noncompliance with which would be material to a major federal financial assistance program. In addition, we are required to review internal controls over nonmajor programs at least once during a three-year cycle.

In planning and performing our audits for the year ended June 30, 1995, we considered the internal control structure of the State of California in order to determine our auditing procedures for the purpose of expressing our opinion on the general purpose financial statements of the State of California, but not to provide assurance on the internal control structure, and on the State's compliance with requirements applicable to major federal financial assistance programs and to report on the internal control structure in accordance with OMB Circular A-128.

The State's management is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of general purpose financial statements in accordance with generally accepted accounting principles, and that federal financial assistance programs are managed in compliance with applicable laws and regulations. Because of inherent limitations in any internal control structure, errors, irregularities, or instances of noncompliance may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we have classified the significant internal control structure policies and procedures in the following categories: financial activities, including electronic data processing controls; state compliance; and federal compliance. We did not study the internal control structures for the pension trust funds, certain enterprise funds, the University of California funds, or certain component unit authority funds.

For all of the internal control structure categories listed in the paragraph above, we obtained an understanding of the design of relevant policies and procedures and determined whether they have been placed in operation, and we assessed control risk. Because of the large number of nonmajor programs and the decentralized administration of these programs, we performed procedures to obtain an understanding of the internal control structure policies and procedures relevant to nonmajor programs on a cyclical basis. The nonmajor programs not covered during the current year are subject to such procedures at least once during the three-year cycle.

During the year ended June 30, 1995, the State of California received 97 percent of its total federal financial assistance through major federal financial assistance programs. We performed tests of controls, as required by OMB Circular A-128, to evaluate the effectiveness of the design and operation of internal control structure policies and procedures that we considered relevant to preventing or detecting material noncompliance with specific requirements, general requirements, and requirements governing claims for advances and reimbursements and amounts claimed or used for matching that are applicable to each of the State of California's major federal financial assistance programs, which are identified in the accompanying schedule of federal financial assistance. Our procedures were less in scope than would be necessary to render an opinion on these internal control structure policies and procedures. Accordingly, we do not express such an opinion.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the State's ability to record,

process, summarize, and report financial data consistent with the assertions of management in the general purpose financial statements or to administer federal financial assistance programs in accordance with applicable laws and regulations.

We discuss the reportable conditions and present recommendations to correct them on pages 35 through 216 of our report. Management's comments regarding the recommendations appear on page 279 of this report. Additionally, beginning on page 264, we present a schedule listing instances of noncompliance that we consider to be minor. Specific responses to the reportable conditions identified at each state agency are on file with the Bureau of State Audits and the Department of Finance. The reportable conditions identified in the State's single audit report for fiscal year 1993-94 that have not been corrected are included in the section beginning on page 35.

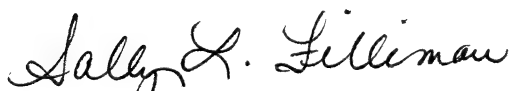
A material weakness is a reportable condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the general purpose financial statements or noncompliance with laws and regulations that would be material to a federal financial assistance program may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure policies and procedures used in relation to the general purpose financial statements or in administering federal financial assistance would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe none of the reportable conditions described above are a material weakness.

In addition to the work we performed in accordance with OMB Circular A-128 and the Single Audit Act of 1984, the Bureau of State Audits performed other reviews related to federal programs. A schedule of the pertinent reports issued from July 1, 1994, to December 31, 1995, begins on page 275 of this report.

This report is intended for the information of the governor and Legislature of the State of California and the management of the executive branch. However, this report is a matter of public record and its distribution is not limited.

BUREAU OF STATE AUDITS



SALLY L. FILLIMAN, CPA
Deputy State Auditor

April 15, 1996

Detailed Description of Weaknesses at State Agencies

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Management Letters by Area of Government

Business, Transportation and Housing

Department of Housing and Community Development

We reviewed the financial operations and related internal controls of the Department of Housing and Community Development (department) and the department's administration of the U.S. Department of Housing and Urban Development grants, Federal Catalog Nos. 14.228 and 14.239.

Summary

We reviewed the financial operations and related internal controls of the department and the department's administration of the U.S. Department of Housing and Urban Development (HUD) grants. We noted the following concerns during our review:

- As of April 23, 1996, the department has not reconciled its records of loans receivable maintained in its program unit to records maintained in its accounting unit for fiscal year 1995-96 loans receivable activity. In addition, the department does not maintain a correct listing of names and addresses for the borrowers of loans recorded in the California Disaster Housing Rehabilitation fund, the Housing Rehabilitation Loan fund, and the Rental Housing Construction fund, totaling approximately \$381,000, \$2.8 million, and \$10 million, respectively. We reported a similar finding in our audit for fiscal year 1993-94. In response to our finding, the department hired an independent CPA firm to reconcile its accounting and program records for loans receivable and provide the accounting adjustments required to properly record the receivables in the accounting records through June 30, 1995. The CPA firm proposed accounting adjustments to the department's accounting records for funds 689, 929, and 938, of \$3.5 million, \$9.5 million, and \$4.6 million, respectively;
- The department's system of internal accounting and administrative controls is not sufficient to ensure that it administers the Community Development Block Grant (CDBG) and Home Investment Partnerships Program (HOME) in accordance with federal and state regulations;
- The department has not adequately monitored the performance of subrecipients of CDBG and HOME grants; and
- The department did not reconcile its federal financial reports prepared during fiscal year 1994-95 with the departmental accounting records. For the six reports we reviewed, we noted differences ranging from \$16,000 to \$472,000. Moreover, as we reported in prior years' audits, the department has not performed reconciliations of its federal financial reports with its accounting records since at least fiscal year 1991-92.

The Department Needs To Improve Its Internal Controls To Ensure Compliance With Federal Requirements

The department is responsible for administering the CDBG and HOME programs in accordance with federal and state regulations. Also, the department is responsible for periodic reporting to HUD on specific operational and fiscal results of the CDBG and HOME programs. However, based on our review of the department's administration of the CDBG and

HOME programs, the department's system of internal administrative and accounting controls is not sufficient to assure that the department is complying with the performance and reporting requirements of federal programs. In order to report on the operational and fiscal results of the CDBG and HOME programs, the department accumulates information in databases maintained in its program and accounting units, and in its official accounting records. However, we found the department does not reconcile the information in its databases to the accounting records, nor does it use information from its accounting records to report program financial information to HUD. In addition, the department sometimes errs in recording transactions in the accounting records. Because of these weaknesses in its internal control system, the department cannot assure that it is complying with the requirements of the federal assistance programs it administers. For example, we noted the following conditions:

- During our review of local assistance expenditures for the HOME program, we tested ten payments and found two items, totaling \$12,300, that the department should have recorded as administrative expenditures. These errors occurred because the department does not have the controls in place to ensure proper accounting codes are assigned to local assistance and administrative expenditures for housing projects.
- In November 1994, the department incorrectly awarded \$273,000 to a community housing development organization (CHDO) for first-time buyer mortgage assistance using HOME funds even though the HOME funds were earmarked for housing to be developed, owned, or sponsored by CHDOs. The department awarded the contract because it had not established the necessary procedures to adequately review applications for HOME funds set aside for CHDOs. The department later revised its application review procedures to be more specific in identifying the activities eligible for CHDO funds. Federal regulations require that at least 15 percent of the State's allocation of HOME program funds must be set aside for housing to be developed, owned, or sponsored by CHDOs.
- Federal regulations allow the department to spend for administrative costs up to 10 percent of repayments of, and interest earned from, loans of HOME funds (program income). However, we found the department used 100 percent of the program income from one HOME loan, totaling \$18,600, to pay administrative costs. The department established a policy to use 100 percent of program income to pay administrative costs during the fiscal year, and adjust its grant records at fiscal year-end to ensure that program income is ultimately allocated between administrative costs and program costs, as required by federal regulations. However, during our review of the grant records for fiscal year 1994-95, we noted the department did not make a year-end adjustment to the June 30, 1995, grant and program allocation records. As a result, the department cannot assure, nor could we determine, that it will ultimately use only 10 percent of the program income to pay for administrative costs.
- Although the department complied with the federal spending limits for administrative costs, during fiscal year 1994-95, it reported administrative costs to HUD for the 1992 and 1993 HOME grants that differed from the costs recorded in its accounting records by \$209,000 and \$30,000, respectively.
- Each year the department prepares reports highlighting the accomplishments of the CDBG and HOME programs. However, the reports covering fiscal year 1994-95 contained errors and were not always supported by program records or reconciled to the accounting records. For example, the annual performance report for the HOME program

contained mathematical errors in the amount of program income reported. In addition, for two of the ten items we tested from the CDBG annual report, the department did not correctly report the amount it awarded to subrecipients for administrative costs. Moreover, the financial information reported regarding federal receipts, disbursements, and program income was not reconciled to the accounting records. Finally, in the CDBG annual report, the department did not include federal drawdowns, totaling \$509,000, that it should have.

Federal regulations require grantees to maintain an effective system of internal control to assure that grantees and subgrantees use cash and other assets solely for authorized purposes. In addition, federal regulations require that grantees maintain accurate accounting records that permit preparation of reports and tracing of funds.

Inadequate Monitoring of Federal Program Subrecipients

During fiscal year 1994-95, the department did not adequately monitor the subrecipients of the CDBG and HOME program funds. As a result, it cannot assure that subrecipients comply with the requirements of the programs when they spend federal funds.

Federal regulations require the department to monitor HOME recipients at least once a year to ensure they comply with the requirements of the program. However, the department has not developed a strategy for meeting that requirement. Moreover, the department has not identified the specific monitoring requirements of the federal regulations or developed a comprehensive policy and procedures to ensure its activities meet the monitoring requirements. Although the department performs activities which are monitoring in nature, it does not maintain records that document the extent of its monitoring activities or that it monitors each contractor or subrecipient at least annually. In addition, the department has not developed and implemented monitoring procedures for all of the elements of the HOME program that they should be reviewing. For example, the department has not developed and implemented procedures to perform monitoring of owners of HOME funded multiple-family rental housing to determine compliance with housing codes and program requirements. In addition, the department has not developed procedures to monitor cash management and financial systems of HOME subrecipients.

We also reviewed the sufficiency of the department's monitoring of local governments that received CDBG funds during fiscal year 1994-95. For the five local governments we reviewed, we found that the department does not always comply with its procedures for conducting monitoring activities. For one of the subrecipients, the department had not performed a financial management review, as required. For another, the department could not provide any documentation to demonstrate that it had followed up with the subrecipient to ensure that action had been taken to correct a deficiency identified in previous years.

Federal regulations state that the department is responsible for monitoring the performance of its subrecipients of HOME funds to assure compliance with program requirements, and for taking action when performance problems arise. In addition, federal regulations require the department to monitor subgrant supported activities to ensure compliance with the requirements of the CDBG program.

The Department Could Not Explain Differences in Indirect Cost Allocations

The department could not explain differences between our calculation of how the department's fiscal year 1994-95 indirect costs should be allocated and its own calculation.

Each month, the department's accounting system allocates its indirect costs to various cost centers based on the amount of labor cost for each cost center. Then, at the end of the fiscal year, using personal computer software, the department reallocates the fiscal year's total indirect costs using information accumulated for the entire year. The department performs this reallocation because it feels that using a whole year's data to do this allocation is more equitable than relying on the monthly allocations. Using the department's methodology, we tested the reallocations of indirect expenses to four program cost accounts. However, our results differed from the department's reallocation by \$258 to \$8,900, or .1 to 11.1 percent. We discussed the results of our calculation with the chief of the budgets office who could not explain the differences between our calculations and the reallocation performed by the department. However, she added that the department has refined the reallocation process by double-checking more of the allocations performed by the personal computer software. In addition, the accounting office, as of July 1, 1995, has automated the reallocations and performs them quarterly, as well as at year-end.

Cost principles for determining allowable costs of programs administered by the State under grants received from the federal government require costs to be allocated to a program only to the extent to which that program benefits from the cost.

The Department Is Not Complying With Federal Cash Management Requirements

The department does not minimize the time between the drawdown of federal funds and the issuance of related warrants by the State Controller's Office (SCO). For 103 local assistance payments for the CDBG program we reviewed, the department disbursed 14 payments, totaling \$2.8 million, one to four days late. We only considered a disbursement late that was delayed more than five days after the receipt of the funds. In addition, the department drew cash advances from the U.S. Treasury, totaling \$125,000, to fund the federal program's share of administrative operating expenses even though federal regulations stipulate that the department should not draw down cash to cover administrative costs until after the costs have been incurred.

On occasion, the department is refunded money that was initially allocated to subrecipients. However, we found that the department is not always promptly applying refunds from recipients to program needs or returning the funds to the federal government, as required. For example, we found the department held 11 CDBG refunds, totaling \$347,000, from 42 to 1,320 days before using the funds to cover program costs or returning the funds to HUD.

In addition, we found the department allows CDBG subrecipients to draw federal funds in advance of expenses and to maintain cash balances in housing rehabilitation loan accounts so the funds are available when contractor billings come due for housing rehabilitation projects. Once the funds are placed in these accounts, however, the department does not monitor the reasonableness of cash balances or require the subrecipients to report the cash balances. According to the CDBG program manager, most subrecipients who draw CDBG funds in

this manner take 7 to 90 days to spend the cash balances they maintain in their housing rehabilitation loans accounts. During fiscal year 1994-95, the department identified approximately \$19.8 million that it had awarded for housing rehabilitation.

Further, the department did not limit the cash advances it paid to subrecipients to their immediate needs. We reviewed 15 payments of cash advances, totaling \$595,800, to CDBG subrecipients for activities other than the rehabilitation projects described above and found that the department disbursed two payments that exceeded the immediate cash needs identified by the subrecipients by \$2,200 and \$600.

Finally, the department made omissions and errors in the work sheets it used to report cash management activities to the Department of Finance (DOF). For example, we reviewed two quarterly reports of draws for local assistance expenditures and two quarterly reports of draws for administrative expenditures and found the department omitted all or part of 15 drawdowns and adjustments, totaling \$424,000. In addition, the department reported incorrect receipt or disbursement dates related to 13 disbursements in two quarterly reports of draws for local assistance expenditures.

Federal regulations require that funds transferred to a state be limited to the minimum amounts required to meet the state's actual and immediate cash needs. In addition, federal regulations require states to monitor cash drawdowns by their subgrantees to ensure that they conform substantially with the same standards of timing and amount as apply to the grantees. Finally, the DOF requires the department to report cash management activity from the CDBG grant to aid the DOF in complying with the requirements of the federal Cash Management Improvement Act.

Issues Reported in Prior Years

The following items are those that were reported in previous years and due to their significance warrant corrective action by the department.

The Department Needs To Continue To Improve Its Controls Over Housing Loans

The department needs to continue to improve its control over loans distributed from the California Disaster Housing Rehabilitation fund (fund 689), Housing Rehabilitation Loan fund (fund 929), and the Rental Housing Construction fund (fund 938). In our audit for fiscal year 1993-94, we reported that the department could not reconcile a difference of approximately \$25.4 million between its accounting records and program records for the three funds. Subsequently, the department hired an independent CPA firm to reconcile its accounting and program records, for loans receivable and provide the accounting adjustments required to properly record the receivables in the accounting records. The CPA firm proposed accounting adjustments to the department's accounting records for funds 689, 929, and 938, of \$3.5 million, \$9.5 million, and \$4.6 million, respectively, to bring the program records and the accounting records into agreement as of June 30, 1995. In addition, to ensure the balances remain in agreement, the CPA firm developed procedures for the department to prepare monthly reconciliations of accounting and program records. However, we noted that, as of April 23, 1996, the department has not performed any reconciliations of accounting and program records for fiscal year 1995-96 loans receivable activity.

Because the department is not performing reconciliations intended to detect errors or omissions in its housing loan records, it cannot provide effective accounting control over housing loans, which in turn protect the public's resources from abuse.

Additionally, the department does not maintain a correct listing of names and addresses for its loans receivable. Using a listing provided to us by the department, we requested the listed borrowers to provide us written confirmation for 114 of the department's recorded loans receivable. However, 11 of the confirmation requests were returned to us by the addressees because the department had not identified correct names and addresses for borrowers. The reasons included clerical errors, files not being updated, disagreement by the listed borrower that they were the borrower, and various other reasons. The balances of the loans we could not confirm using the department's information for funds 689, 929, and 938, totaled approximately \$381,000, \$2.8 million, and \$10 million, respectively. By not maintaining accurate information on recipients of housing loans, the department increases the risk that some of its receivables will become uncollectible.

State law requires departments to maintain an effective system of internal control which includes procedures that provide for effective control over assets, liabilities, revenues, and expenditures. In addition, the State Administrative Manual, which outlines fiscal policies for state agencies to follow, discusses the importance of preparing reconciliations. Properly prepared reconciliations represent an important element of internal control because they provide a high level of confidence that transactions have been processed properly and that the financial records are complete.

The Department Has Not Identified Adjustments to Correct Its Commingling of Federal Grant Funds

The department has not completed its work to identify adjustments to federal grant balances it may need to make because it improperly commingled the receipts from the federal grants it administered from at least fiscal years 1989-90 through 1993-94. In our fiscal year 1993-94 audit, we reported that since at least fiscal year 1989-90, the department had commingled approximately \$258 million in cash from nine federal programs in its Federal Trust Fund. According to the department, it had been using the Federal Trust Fund as a "melting pot" of federal dollars, in that expenditures for federal grants lacking available cash were paid for by federal grants having available cash. Because of this commingling of funds, the department could not determine actual cash balances for specific federal grants.

Subsequent to our audit for fiscal year 1993-94, the department hired an independent CPA firm to reconcile program records of federal and state housing grant receipts and disbursements to the department's official accounting records and create a fund balance statement for each program. However, the CPA firm has not yet completed those tasks or identified any adjustments to the department's grant balances to correct the effects of its commingling of federal grant funds. The department's contract manager anticipates having this work completed by June 30, 1996, and recording any adjustments to the accounting records in the June 30, 1997, financial statements.

Federal regulations require states to maintain accurate accounting records that contain current and complete disclosure of financial activities relating to a federal grant. In addition, the regulations require grantees to maintain effective control and accountability for all grant cash

and that actual expenditures or outlays must be compared with budgeted amounts for each grant or subgrant. Finally, the regulations require states to limit requests for federal funds to the minimum amount required to meet their actual and immediate cash needs.

Federal Financial Reports Are Not Supported or Reconciled

The department did not reconcile its federal financial reports prepared for fiscal year 1994-95 with its accounting records. Moreover, in our fiscal year 1993-94 audit, we reported that the department had not performed reconciliations of its individual grant revenues and expenditures since at least fiscal year 1991-92. Failure to reconcile federal financial reports with the accounting records can result in misstated reports of the drawdowns and disbursements of federal funds that are not supported by the department's accounting records and may go undetected. We noted the following when the department did not reconcile its federal financial reports:

- In its administration of the CDBG and HOME programs, the department is required to prepare a quarterly Report of Federal Cash Transactions (SF-272), which shows receipts and disbursements and cash on hand balances of federal funds during the period of the report. However, the reports the department prepared for fiscal year 1994-95 were not supported by or reconciled with any data from the department's accounting system. In addition, the reports prepared for the CDBG grants did not accurately disclose balances for disbursements and did not disclose any amounts for refunds of expenditures, adjustments to cash balances, or beginning or ending cash on hand balances. For both the CDBG and HOME grants, the department reported receipts that did not agree with the accounting records. For the six reports we reviewed, we noted differences ranging from \$16,000 to \$472,000. For disbursements, the department simply reported the same amount it reported for receipts.
- During fiscal year 1994-95, the department did not agree receipts of CDBG and HOME program funds recorded in its accounting records to balances maintained by the SCO, but instead attempted to reconcile its receipts and disbursements of federal funds to balances maintained by the SCO by comparing the net change in its CDBG and HOME program cash balances each month to a similar figure in the SCO's records, and did not separately compare totals for receipts, disbursements, and adjustments. When we attempted to reconcile fiscal year 1994-95 receipts for federal programs recorded in the department's accounting records to the SCO's balances, we found differences of \$118,000 and \$54,000 for the CDBG and HOME grants, respectively.

Federal regulations require the department to maintain accurate accounting records that permit the preparation of reports and tracing of funds as well as accurate, current, and complete disclosure of financial activities related to the grant. Additionally, state administrative policy requires agencies receiving federal funds to reconcile federal financial reports with the official accounting records and retain all supporting schedules and work sheets for a minimum of three years.

The Department Lacks Adequate Control Over Its Revolving Fund

In prior years' audits, we reported that, in June 1990, the department improperly used the revolving fund to pay the Department of Transportation approximately \$1.3 million under an agreement to provide services. In addition, the department did not have sufficient appropriations available from the State's General Fund to reimburse its revolving fund for a \$364,000 balance remaining from the \$1.3 million payment. In response to numerous reports of this finding by the SCO, the DOF, and the Office of the Auditor General, the department has requested approval from the DOF to reimburse its revolving fund at the end of fiscal year 1995-96 using its support appropriations from housing development and rehabilitation funds administered by the department. As of April 1996, the department has not received approval from the DOF.

We also noted that the department did not promptly request reimbursement for its revolving fund. Specifically, 5 of the 6 revolving fund disbursements we reviewed for employee travel expenses were reimbursed 78 to 117 days after the department issued the revolving fund checks. Additionally, 10 of 11 revolving fund disbursements for travel expense advances were reimbursed 38 to 274 days after the end of the month in which the travel occurred. As of June 30, 1995, the department had unreimbursed revolving fund disbursements recorded as travel expense, office expense, and salary advances, totaling approximately \$416,000, that had been outstanding for more than 60 days. Approximately \$364,000 of the outstanding balance is the remaining portion of the \$1.3 million payment which was improperly made from the revolving fund in June 1990. State administrative procedures require state agencies to schedule claims for reimbursement of office revolving funds promptly. Weaknesses in control over revolving fund disbursements could result in the misuse of state funds.

Untimely Submission of Annual Cost Allocation Proposal

The department did not submit its fiscal year 1994-95 cost allocation proposal to the DOF and HUD within the required time period. Cost principles for determining allowable costs of programs administered by the State under grants received from the federal government require states and local governments to establish a cost allocation proposal to support the distribution of any joint costs related to the grant program and to have the proposal approved by a designated federal agency. Although state administrative procedures require the department to submit its proposal for allocating indirect costs to federal programs 6 months before the start of the fiscal year to which the proposal applies, the department was 17 months late when it submitted its fiscal year 1994-95 cost allocation proposal to the DOF for approval in May 1995. In addition, the department did not submit its fiscal year 1994-95 cost allocation proposal to HUD for approval until October 1995. As a result, it increases the risk that it is using federal funds beyond the limits allowed for administering federal grant programs.

Other Instances of Noncompliance With Federal and State Requirements

In the following instances the department did not comply with certain federal or state requirements.

Disbursement of Federal Funds Prior to Written Determination of Exemption From Environmental Review

For 3 of 13 items we sampled, the department approved disbursement of federal funds to HOME and CDBG recipients prior to acquiring written determination that the projects or activities were exempt from environmental review. When the department approves disbursements before acquiring the required documentation, it cannot be sure that recipients have met environmental review requirements for proposed projects.

CDBG Grantee Reports Submitted Late

In our testing of 19 quarterly activity reports, we found that grantees did not comply with state requirements and submitted 13 reports from 2 to 128 days late. In addition, 10 of 14 annual performance reports submitted by grantees were 1 to 143 days late. Timely reports are essential to ensure that grantees use funds appropriately, do not exceed their budgets, and make appropriate progress with their projects. We reported a similar issue in prior years

The Department Lacks Control Over Travel Expenditures

The department paid invoices for airline and rental car charges without verifying that the charges were valid. For fiscal year 1994-95, the department reported total airline expenditures of approximately \$78,800 and total rental car expenditures of approximately \$19,000. We reviewed approximately \$64,400 of airline expenditures and approximately \$9,500 of rental car expenditures and found that the payments, totaling \$51,800 and \$8,800, respectively, had not been approved by a supervisor.

When travel expenses are not properly reviewed, the department cannot ensure it is paying only actual costs incurred for state service. For example, for one of ten disbursements, we found the department had reimbursed an employee for four nights' lodging when the receipts submitted with the employee's travel expense claim only supported three nights' lodging.

Recommendations

To improve its internal accounting and administrative controls over the CDBG and HOME federal assistance program activities, the department should:

- Ensure that proper program cost accounts are established in the accounting records to segregate and accumulate local assistance and administrative costs to a detail level that is useful to the program units for performance monitoring and reporting;
- Provide updated and accurate information to its employees responsible for reviewing applications for HOME program funds to ensure the department awards HOME funds for only eligible activities;
- Implement oversight procedures sufficient to ensure it complies with its policies regarding the treatment of program income;

- Develop and implement procedures to ensure that financial and statistical data included in financial and annual reports to HUD are supported by information collected by the department and reconciled to the accounting records;
- Continue its efforts to identify any adjustments to its federal grant balances that resulted from its commingling of federal grant funds;
- Prepare and submit for approval in a timely manner its proposal for allocating indirect costs to federal grants to gain assurance it is using federal funds within the limits allowed for administering federal grant programs; and
- Ensure that CDBG subgrantees have met environmental review requirements before disbursing grant funds. In addition, ensure subgrantees submit quarterly activity reports by the required due dates.

To ensure that it is performing adequate monitoring of subgrantees, the department should develop and implement the necessary review procedures for all aspects of the HOME program. In addition, the department should follow its review procedures for monitoring CDBG subgrantees.

The department should perform the tests necessary to ensure software applications are correctly allocating its indirect costs, to gain assurance it charges federal grants only their fair share of allowable indirect costs.

To ensure it minimizes the time between the draw and disbursement of federal funds, the department should follow the cash management requirements for draws, disbursements, and reports of federal funds provided by federal regulations and the DOF.

To improve its control over housing loans, the department should perform monthly reconciliations of the loans receivable recorded in its accounting records with data accumulated in the program units to ensure the completeness and accuracy of financial data.

To improve its internal controls over office revolving fund and travel expenditures, the department should:

- Seek prompt reimbursement for expenses and advances paid from the revolving fund;
- Ensure that it does not pay airline or car rental invoices without proper approvals; and
- Ensure requests for revolving fund payments for travel expenses are supported by expense receipts.

Appendix

U.S. Department of Housing and Urban Development

<u>Federal Catalog Number</u>	<u>Program Title</u>
14.228	Community Development Block Grants State's Program
14.239	Home Investment Partnerships Program

Federal and State Criteria

Internal Control

The California Government Code, Sections 13401 and 13403, requires agencies to maintain an effective system of internal control which includes recordkeeping procedures to provide effective accounting controls over assets, liabilities, revenues, and expenditures.

The State Administrative Manual, Section 7900, discusses the importance of reconciliations. Properly prepared reconciliations represent an important element of internal control because they provide a high level of confidence that transactions have been processed properly and that the financial records are complete.

The State Administrative Manual, Section 20014, requires agencies receiving federal funds to reconcile federal financial reports to the official accounting records and return all supporting schedules and work sheets for a minimum of three years.

The State Administrative Manual, Section 8047, requires state agencies to promptly schedule claims for reimbursement of office revolving funds.

The State Administrative Manual, Sections 8422.114 and 8422.115, describes procedures for processing airline and rental car invoices.

Cost Principles

The Office of Management and Budget (OMB), Circular A-87, requires the department to establish a cost allocation proposal to support the distribution of joint costs related to the grant program, that all costs included in the proposal be supported by formal accounting records, and that the proposal be submitted to the designated federal agency for review and approval. In addition, the cost principles contained in OMB Circular A-87 are designed to provide that federally assisted programs bear their fair share of costs.

The State Administrative Manual, Section 8755.2, requires departments to submit cost allocation proposals to the DOF for approval prior to submitting the proposal to the cognizant federal agency for approval. In addition, Section 8756.1 requires state agencies to submit their cost allocation proposal to the cognizant federal agency at least six months before the start of the fiscal year to which the proposal applies.

Reporting Requirements

The California Code of Regulations, Title 25, Section 7108(e), requires subrecipients to submit quarterly reports to the department within 30 days after the end of the reporting period. In addition, the department's CDBG Grant Management Manual requires subrecipients to submit quarterly activity reports within 30 days after the close of each quarter.

The department's CDBG Grant Management Manual requires subrecipients to submit annual performance reports by July 31 of each year.

Cash Management

The Code of Federal Regulations, Title 31, Section 205.7 and Title 24, Section 85.21(b), requires that the State minimize the time elapsing between the transfer of funds from the U.S. Treasury and the disbursement of funds by the State and its subrecipients for program purposes.

The Code of Federal Regulations, Title 31, Section 205.7, also requires the State to limit its requests of federal funds to the minimum amounts required to meet the State's actual and immediate cash needs.

The Code of Federal Regulations, Title 31, Section 205.9(f), requires states that do not have a Treasury-State agreement in effect after the later of June 30, 1993, or the last day of the state's 1993 fiscal year to follow the default procedures prescribed by the U.S. Secretary of the Treasury. The default procedures indicate that the DOF is responsible for implementing the federal Cash Management Improvement Act (CMIA). The DOF requires departments to gather information for calculating the State's CMIA interest liability and to submit the information to the DOF using the CMIA work sheets. In addition, the default procedures for the CDBG program require that drawdowns for program administrative costs should be for reimbursement and requested after costs are allocated by the department.

Accounting Records

The Code of Federal Regulations, Title 24, Section 85.20, requires the State and its subgrantees to maintain accurate accounting records that permit preparation of reports and tracing of funds, as well as the accurate, current, and complete disclosure of its financial activities relating to the federal grant. In addition, the section states that effective control and accountability must be maintained for all grant and subgrant cash, and that actual expenditures or outlays must be compared with budgeted amounts for each grant or subgrant. Finally, the section states that grantees and subgrantees must adequately safeguard such cash and property and must assure that it is used solely for authorized purposes.

The State Administrative Manual, Section 20014, requires agencies receiving federal funds to reconcile federal financial reports with the official accounting records and retain all supporting schedules and work sheets for a minimum of three years.

Specific Federal Compliance

The Code of Federal Regulations, Title 24, Section 92.300(a), requires the department to reserve at least 15 percent of HOME grant funds to be used only for housing that is to be developed, owned, or sponsored by community housing development organizations.

The Code of Federal Regulations, Title 24, Section 207, states that grantees in the HOME program may use up to 10 percent of any return of the HOME program investment for administration and planning costs.

The Code of Federal Regulations, Title 24, Sections 85.40 and 92.504(e), states that grantees in the CDBG and HOME programs are responsible for monitoring the performance of all entities receiving grant funds and ensuring compliance with program requirements. In addition, the Code of Federal Regulations, Title 24, Section 92.504(e), requires that the State monitor the performance of each contractor and subrecipient at least annually. The section further requires the State to conduct on-site reviews of HOME multiple-family rental housing projects to determine compliance with housing codes and the requirements of the program.

The Code of Federal Regulations, Title 24, Section 85.20(b)(7), requires the State to monitor the cash drawdowns by its subrecipients to assure they comply substantially with the same cash management standards for timing and amount that apply to the State.

The department's program monitoring handbook for the CDBG program includes procedures to determine whether subgrantees have implemented a financial management system that is adequate to ensure compliance with the financial requirements of the program.

The Code of Federal Regulations, Title 24, Section 58.22, requires that the State not commit HOME and CDBG funds until subrecipients have met the environmental review requirements of the Code of Federal Regulations, Title 24, Part 58.

The Code of Federal Regulations, Title 24, Section 58.34(b), states that CDBG subrecipients that carry out activities which are exempt from environmental review requirements must document in writing their determination that each activity or project is exempt from environmental review and meets the conditions specified for exemption.

Department of Motor Vehicles

We reviewed the financial operations and related internal controls of the Department of Motor Vehicles (department).

The Department Does Not Ensure Its Computer System Correctly Records the Fees It Collects

The department does not always ensure its computer system records fees in accordance with state statutes and the department's intentions. These fees are to be made available to state and local government agencies, and participants of special programs, to fund various programs. In addition, the California Government Code permits the department to collect service fees from vehicle owners whose checks are dishonored by their banks, as reimbursement of the department's costs to process those dishonored checks. During our review of the department's fiscal year 1994-95 revenues, we noted the following:

- In November 1995, in our report titled "Department of Motor Vehicles: Collegiate License Plate Revenues Have Been Overallocated," we reported that due to incorrect programming in its computer system, the department had overallocated approximately \$15,500 of license fee revenue to the participant of the collegiate license plate program.
- During the period January 1, 1995, through June 30, 1995, the department collected additional vehicle registration fees for the support of the California Highway Patrol (CHP). However, because it did not make the necessary programming changes in its computer system, the department did not identify approximately \$6,000 of those fees in its accounting records and make them available to support the CHP as required by the Vehicle Code.
- The department charges vehicle owners a \$20 service fee to recover its costs for each dishonored check it processes. However, the department's internal auditor found that under certain circumstances, the department's computer system incorrectly records a portion of those fees in its accounting records as Motor Vehicle License Fee Account revenue rather than as Motor Vehicle Account revenue.

Because the department does not always ensure that its computer system properly records the fees it collects, those fees are not always available for their intended purpose.

The computer system did not correctly record the fees because the department failed to change the programs to agree with changes in the law or used the programs before ensuring they produced the intended result. In addition, the department did not adequately monitor the reports provided by its computer system to determine if anticipated revenues and fees were recorded.

Issue Reported in Prior Years

We reported the following issue in our audits for fiscal years 1992-93 and 1993-94, and due to its significance, this issue warrants corrective action by the department:

Inadequate Control Over Dishonored Checks

The department does not have sufficient control over dishonored checks. As of June 30, 1995, the department had approximately 106,000 checks, totaling \$27 million, that banks had not honored. The department transferred the responsibility and authority for collection of delinquent vehicle registration fees, in excess of \$250, to the Franchise Tax Board (FTB). However, the department does not reconcile the checks transferred to the FTB to the checks collected or being pursued by the FTB. As a result, the department cannot ensure that all of the dishonored checks for vehicle registration are accounted for.

According to the Manager of the Cash Management and Cashiering Section, the department is unable to reconcile the dishonored checks sent to the FTB for collection to the account information at the department because of the unavailability of an automated data exchange process between the two agencies. He also stated the current manual process is not all-inclusive and creates several logistical and timing issues relative to payments, adjustments, and corrections.

In response to our prior years' reports, the department stated it was developing a system to transfer dishonored checks information electronically between the department and the FTB. According to the Manager of the Cash Management and Cashiering Section, although the department has completed the specifications, it will take an additional 18 months to implement the new system.

Recommendations

To ensure the fees it collects are correctly recorded and available for their intended purpose, the department should adequately update and test its computer programming designed to record those fees in its accounting records. In addition, the department should adequately monitor the reports provided by its computer system to ensure revenues and fees are recorded as intended by the department.

To improve its control over dishonored checks, the department should develop and implement a system to reconcile the dishonored checks it transfers to the FTB for collection to the dishonored checks the FTB has collected and is pursuing for collection.

Appendix

Criteria

The California Government Code, Section 13403, states that the elements of a satisfactory system of internal accounting and administrative control should include, but are not limited to, a system of authorization and recordkeeping procedures that effectively control assets, liabilities, revenues, and expenditures.

Stephen P. Teale Data Center

We reviewed the financial operations and related internal controls of the Stephen P. Teale Data Center (data center).

Some Service Costs Not Fully Recovered

During fiscal year 1993-94, the data center entered into an interagency agreement with the Department of Motor Vehicles (DMV) to provide computing services over a five-year period for a project called Network 2000. To facilitate this agreement, the data center added a new rate to its published rate schedule and billed DMV for services based on the number of transactions the DMV processed each month. This billing procedure differs from the data center's standard procedure of billing customers for actual system services used, as well as any equipment used exclusively for that customer. Because it billed the DMV for the number of transactions processed rather than use its existing rates to bill the DMV for services provided, by June 30, 1995, the data center had incurred costs that exceeded the billings it made to the DMV by more than \$3.1 million.

According to the Assistant Director of Administration and Finance, to meet the needs of its agreement with DMV, the data center purchased equipment during the start-up phase of the project. We determined that to finance these start-up costs, the data center is using surpluses that it has accumulated over the past few years. However, since the data center is required to operate on a break-even basis, it should return any surpluses from past years to its customers by lowering its service rates. Furthermore, we determined that if the data center had used its standard procedures for billing customers, it would have recovered the start-up costs for the project. Moreover, although the data center did reduce its billing rates for fiscal years 1994-95 and 1995-96, it could have reduced them even further had it recovered its costs for the DMV project. Finally, by using the surpluses from past years to recover a portion of the costs of the DMV project, the data center is actually charging those costs to other state agencies.

State regulations require the data center to provide services to other state agencies on a break-even basis each fiscal year and to recover its full costs whenever it provides goods or services to other agencies. The Assistant Director of Administration and Finance stated that the data center planned to break even over the five-year term of the project. He also stated that any deficits that the data center incurs in the beginning of the contract period will be made up by surpluses during the remaining period of the agreement. However, as stated earlier, if the data center had followed its standard procedures for billing agencies for services used and equipment used exclusively for that agency, it would have recovered its costs for the DMV project each year.

Issue Reported in Previous Years

The data center does not have adequate separation of duties in its accounting section. As we reported last year, the same accounting analyst that maintains the general ledger and prepares the bank reconciliation also has access to blank check stock. State administrative procedures require agencies to separate functions so that the person who reconciles bank accounts and

maintains the general ledger, or any subsidiary ledger affected by cash transactions, does not have access to the blank check stock. Failure to adequately separate accounting duties can result in errors, irregularities, or illegal acts that may go undetected for extended periods.

Minor Issues of Noncompliance With State Requirements

In the following instances, the data center did not always comply with state administrative requirements:

- The data center did not adequately follow up on its receivables. Specifically, we reviewed eight delinquent accounts and found that the data center could not demonstrate that it had made any effort to follow up on six of the eight accounts. These six accounts totaled more than \$1.1 million.
- The data center did not prepare monthly reconciliations of the accounting records that it uses to prepare financial reports and similar records maintained by the State Controller's Office. In addition, it did not reconcile prior-year appropriations to balances reported by the State Controller's Office during fiscal year 1994-95. Finally, for the current year appropriation reconciliation that it did prepare, the data center did not always ensure that the individuals who prepared and reviewed the reconciliations had signed and dated them.
- As of November 1995, the data center had not prepared general ledger reports or the related financial statements for the period July through September 1995.
- The data center did not always take discounts available to them on invoices it paid. Of the 30 payments that we reviewed, 7 offered discounts; however, we noted that the data center did not exercise the option to take 3 of the discounts.
- The data center does not always ensure payments are authorized. Specifically, the data center does not obtain approval from appropriate data center staff before paying invoices for taxi services.

Recommendations

To ensure that it operates on a break-even basis each fiscal year the data center should recover full costs of the services that it provides to other agencies.

To improve its system of internal controls the data center should:

- Establish and maintain adequate separation of duties in its accounting section;
- Follow up on outstanding receivables by sending collection letters to those agencies whose accounts are delinquent;
- Each month reconcile the accounting records that it uses to prepare financial statements to reports maintained by the State Controller's Office;

- Each month reconcile prior year appropriations to balances reported by the State Controller's Office;
- Prepare the general ledger reports and the related financial statements on a timely basis;
- Ensure that it takes discounts on invoices whenever they are available; and
- Ensure that the proper approval for obtaining goods and services exists prior to issuing payments for those items.

Appendix

Operational Requirements

The State Administrative Manual, Section 4982.2, requires the data center to operate on a break-even basis each fiscal year. In addition, the section requires the data center to charge its users for units of service according to a published service rate schedule.

The State Administrative Manual, Section 8752, requires the data center to recover its full costs whenever it provides goods or services to others.

The State Administrative Manual, Section 8776.6, requires state agencies to send a series of three collection letters, at 30-day intervals, to debtors that have not promptly paid amounts due. Further, this section requires state agencies to perform an analysis to determine what additional efforts should be taken if the debtor does not respond to the three collection letters.

Internal Control Requirements

The State Administrative Manual, Section 8080, states that the duties of authorizing disbursements, signing checks after reviewing supporting documents, and reconciling bank accounts and posting the general ledger should be performed by different persons. The section further states that persons who reconcile bank accounts and maintain the general ledger, or who sign checks manually after reviewing supporting documents, should not have access to the blank check stock.

The State Administrative Manual, Section 8422.1, requires state agencies to determine that authority existed to obtain goods or services prior to paying invoices. In addition, the section requires state agencies to take discounts when they are offered.

The State Administrative Manual, Section 7900, requires the data center to perform monthly reconciliations between its accounting records and similar accounts maintained by the State Controller's Office.

The State Administrative Manual, Section 7908, requires that all reconciliations show the name of the preparer and the reviewer as well as the dates prepared and reviewed.

The State Administrative Manual, Section 7959, requires agencies to monthly reconcile with the State Controller's balances, any prior-year appropriations that are no longer available for encumbrance but have not reverted.

Reporting Requirements

The State Administrative Manual, Section 7951, requires state agencies to prepare quarterly reports, excluding the quarter ending June 30, by the 15th day of the month following the quarter.

Department of Transportation

We reviewed the financial operations and related internal controls of the Department of Transportation (department) and the department's administration of the U.S. Department of Transportation grant, Federal Catalog No. 20.205.

Minor Issues of Noncompliance With Federal and State Requirements

In the following instances, the department did not comply with certain federal or state requirements.

Noncompliance With Federal Requirements

- The department placed an advertisement in the State's Contract Register prior to obtaining Federal Highway Administration (FHWA) approval for a \$6.5 million construction project. Federal regulations specifically require the State to obtain FHWA authorization before advertising for bids on construction projects. Without prior approval, the State assumes a risk that the FHWA may choose to not participate and therefore, may not reimburse the State for the contract awarded. However, in this instance, the department did eventually obtain authorization from the FHWA.

Noncompliance With State Requirements

- For 2 of the 45 personnel transactions tested, the department could not locate attendance and leave records. However, in April 1996, the department located the supporting documentation, six months after our initial request for the information.

Recommendations

To ensure that it complies with federal requirements for its Highway Planning and Construction Program, the department should:

- Ensure that it obtains written approval from the FHWA prior to advertising its construction projects.

To improve its system of internal controls, the department should:

- Maintain personnel records for a minimum of four years.

Appendix

U.S. Department of Transportation Grants

<u>Federal Catalog Number</u>	<u>Program Title</u>
20.205	Highway Planning and Construction Program

Federal and State Criteria

Federal Authorization

The Code of Federal Regulations, Title 23, Section 635.112(a), requires state agencies to obtain authorization from the FHWA administrator prior to the start of any federal project or advertisement for bids.

Record Retention

The State Administrative Manual, Section 1668, lists general retention schedules for personnel and payroll records. Specifically, this section requires agencies to retain absence reports for a period of four years.

Education

California Community Colleges, Chancellor's Office

We reviewed the financial operations and related internal controls of the California Community Colleges, Chancellor's Office (Chancellor's Office) and the Chancellor's Office's administration of the U.S. Department of Education grant, Federal Catalog No. 84.048; the U.S. Department of Labor grant, Federal Catalog No. 17.250; and the U.S. Department of Health and Human Services grant, Federal Catalog No. 93.561.

Summary

We reviewed the financial operations and related internal controls of the Chancellor's Office and its administration of U.S. Department of Education, U.S. Department of Labor, and U.S. Department of Health and Human Services grants. Specifically, we noted the Chancellor's Office:

- Lacked documentation to support personnel costs charged to federal programs. Thus, the Chancellor's Office cannot assure that personnel costs charged to federal programs reflect actual work performed.
- Needs to improve its cash management over vocational education funds. Specifically, the Chancellor's Office overbilled the California Department of Education (CDE) for reimbursement of expenditures for various vocational education programs. Further, the Chancellor's Office disbursed funds to subrecipients in excess of their actual, immediate cash needs.
- Did not sufficiently monitor audit reports of community college districts. As a result, the Chancellor's Office did not ensure that the districts promptly resolved instances of noncompliance with federal and state laws and regulations.

Lack of Documentation To Support Personnel Costs

The Chancellor's Office lacked documentation to support the payroll charges allocated to federal programs. Specifically, the Chancellor's Office did not base payroll costs charged to federal grants on employee time sheets. Rather, these charges were allocated based on the division vice chancellors' estimates of the percentage of time staff spend administering various federal grants. For example, the vice chancellor over the Economic Development and Vocational Education division developed the percentages based on scope of work, skills and talents of staff, sources of funds available, prior time studies, and adjustments for the completion of existing projects or for the emergence of new opportunities. However, this method does not ensure that the Chancellor's Office charges federal programs only for actual time worked and these percentages may not reflect how employees actually spend their time. In addition, because it received approximately \$78 million of funding from nine federal grants, along with funds from various state sources, during fiscal year 1994-95, the Chancellor's Office should use a more precise method to charge time to federal grants.

In April 1995, the U.S. Department of Education also noted this issue in its Carl D. Perkins, Monitoring Visit of the Chancellor's Office. In response, in July 1995, the Chancellor's Office's Economic Development and Vocational Education division instructed its employees to

begin using time reports. However, these time reports are not the direct basis for the division's payroll charges; rather the division uses the time reports to update the preset percentages. Furthermore, other units within the Chancellor's Office that receive some federal funds still do not use time reports to document the amount of time employees spend administering the federal grants.

Federal regulations require that charges to federal grants for employee salaries charged to more than one federal program be supported by activity reports that reflect an after-the-fact distribution of the actual activity of each employee. Further, federal regulations also state that budget estimates or other predetermined percentages do not qualify as support for payroll unless adjusted, at least quarterly, to the actual time spent.

Improvements Needed Over Cash Management

The Chancellor's Office did not always properly manage its federal vocational education funds. As an intermediary in the allocation of these funds between the CDE and subrecipients, including community college districts, each fiscal year, the Chancellor's Office enters into agreements with the CDE for a portion of the federal vocational education funds. During our audit, we noted the following conditions:

- As we have reported in previous years, the Chancellor's Office overbilled and underbilled the CDE for reimbursement of expenditures for various vocational education programs in fiscal year 1994-95. Specifically, during our review of billings through July 1995 and various adjustments, we found that the Chancellor's Office overbilled the CDE a net of approximately \$706,000. The primary reasons this overbilling occurred are that the Chancellor's Office billed for one particular vocational education expenditure twice, and it billed for an estimated amount of the vocational education program's first principal apportionment, rather than for the actual amount of the apportionment. Also, although the Chancellor's Office has a system in place to reconcile billings with actual expenditures, it did not perform the reconciliation. However, the Chancellor's Office has recently staffed this position and implemented an improved procedure to reconcile billings to the CDE with its expenditures. This procedure should help to reduce or eliminate the occurrences and amounts of overbilling.
- Its method for disbursing vocational education funds to subrecipients did not ensure that the Chancellor's Office provides cash to meet the subrecipients' actual needs. These funds are disbursed through the apportionment process. We reviewed disbursements for 30 vocational education grant agreements and found that the Chancellor's Office disbursed to 10 subrecipients approximately \$318,000 more than their actual cash needs. The amount of excess cash per recipient ranged from \$6,000 to \$89,000. Conversely, we found that the Chancellor's Office disbursed to 6 other subrecipients approximately \$174,000 less than their actual cash needs. These disbursements ranged from \$6,500 to \$104,000 below the actual cash needs of the subrecipients.

Federal regulations require that federal funds transferred to the State be limited to the actual, immediate cash needed. Further, federal regulations require the State to minimize the time between the transfer of federal funds and the disbursement of those funds for program

purposes. Finally, federal regulations require that cash advances made by primary recipients to subrecipients conform substantially to the same standards of timing and amount as those that apply to cash advances by federal agencies to primary recipients.

Insufficient Monitoring of Community College District Audit Reports

The Chancellor's Office did not sufficiently monitor the audit reports of the State's 71 community college districts for fiscal years 1993-94 and 1994-95. Under state law, the Chancellor's Office has oversight responsibility to ensure that instances of noncompliance noted in audit reports of community college districts are promptly resolved. We reviewed the process for monitoring these audit reports and found the following:

- The Chancellor's Office did not ensure that community college districts promptly and appropriately resolved instances of noncompliance with federal and state laws and regulations noted by the auditors.
- While the Chancellor's Office did review all of the fiscal year 1993-94 audits to ensure that they met appropriate standards, it only reviewed 20 of the 71 audits for fiscal year 1994-95. Further it did not notify the community college districts of its acceptance or rejection of the audit reports. In addition, the checklist the Chancellor's Office used to review these audit reports lacked a step to verify the disclosure of fraud, abuse, or illegal acts.
- Of the 71 community college districts, 21 did not submit their fiscal year 1993-94 audit reports within six months after the close of their fiscal year, as required. In addition, 20 community college districts were late in submitting their audit reports for fiscal year 1994-95.

Because the Chancellor's Office is not properly monitoring audit reports, it cannot assure that community college districts promptly and appropriately resolve instances of noncompliance with federal and state laws and regulations. Further, late resolution of audit issues, including administrative findings and questioned costs, can result in additional questioned costs if the community college districts do not correct deficiencies within a reasonable time frame. Finally, if the Chancellor's Office does not inform community college districts when audit reports do not meet audit standards, the community college districts are unable to ensure that deficient audit reports are revised to meet audit standards.

Federal regulations require the Chancellor's Office to ensure that community college districts take appropriate action to resolve instances of noncompliance with federal laws and regulations noted in an independent audit. Further, federal regulations require that the Chancellor's Office ensure that community college districts take corrective action within six months after receipt of the audit reports. Additionally, federal regulations state that a separate report should cover all fraud, abuse, illegal acts, or indications of such acts. Moreover, state regulations require the Chancellor's Office to monitor the completion of community college district audit reports and ensure that audit findings are resolved. Finally, state regulations require community college districts to submit their audit reports to the Chancellor's Office within six months after the close of their fiscal year.

Failure To Monitor Matching Funds for the Matriculation Program

The Chancellor's Office did not monitor the matriculation program to ensure that community college districts matched state funds as required by state regulations. In fiscal year 1994-95, the Chancellor's Office provided more than \$43 million to the State's community college districts for the matriculation program. The primary purpose of the matriculation program is to ensure that all students complete their college courses, continue to the next academic term, and achieve their educational objectives. If the Chancellor's Office does not adequately monitor the program it has no assurance that each community college district properly matched its matriculation funds or that the districts operated the program at the level intended.

State regulations require community college districts to match each dollar of state matriculation funding with three dollars of their own funds. These matching funds must be devoted to the matriculation program.

Issues Reported in Prior Years

The following items were reported in previous years and due to their significance, warrant corrective action by the Chancellor's Office.

Incorrect Calculations of Apportionments

The Chancellor's Office incorrectly calculated the apportionments for both the Disabled Student Programs and Services (DSP&S) and the Extended Opportunity Programs and Services (EOPS) programs. During our audit, we noted the following conditions:

- The allocations to college campuses for the DSP&S program were incorrectly calculated. Specifically, the Chancellor's Office did not use the corrected fiscal year 1992-93 weighted student count data in its calculation of the fiscal year 1994-95 apportionment for two colleges. As a result, the general allocation for all colleges indicating growth was affected because the Chancellor's Office partly based this component of the allocation on weighted student count data. For example, one college received approximately \$4,600 more than it should have for fiscal year 1994-95 due to incorrect weighted student count data. Furthermore, incorrect general allocations in one year affect subsequent years' allocations because the allocations are based, in part, on the prior year's data.

As required under state rules and regulations, the Chancellor's Office adopted a formula for allocating DSP&S funds which specifies that a portion of the funds shall be allocated on the basis of growth in weighted student counts.

- The EOPS allocation was not calculated in accordance with the EOPS allocation formula. Specifically, the Chancellor's Office used allocation data from the wrong fiscal years to determine the appropriate allocations for colleges' efforts to encourage enrollment of disadvantaged students. Furthermore, it used estimates rather than final expenditures for nine campuses. The Chancellor's Office estimated the expenditures for these nine campuses because it had not received final expenditure reports from the campuses.

Because the Chancellor's Office did not calculate the EOPS allocation in accordance with its formula, some campuses may not have received all of the funds they were entitled to receive. Furthermore, incorrect allocations in one year affect subsequent years' allocations because the allocations are based, in part, on the prior year's data.

To comply with rules and regulations over the EOPS programs, the Chancellor's Office adopted a formula that allocates a portion of the EOPS funds based upon each college's level of effort. In its formula to determine the level of effort, the Chancellor's Office includes the most recent final expenditure information available and the allocation amounts that the campuses received for the previous three fiscal years.

Federal Financial Report Not Supported or Reconciled

The Chancellor's Office did not reconcile with its accounting records one of the federal financial status reports that it prepared for the vocational education program during fiscal year 1994-95. Specifically, we found that the final federal financial status report relating to the fiscal year 1992-93 allocation of vocational education funds was not reconciled to the Chancellor's Office's accounting records. In addition, the Chancellor's Office could not provide support for certain expenditure amounts on this federal report.

The Chancellor's Office submits federal financial status reports to the CDE and the CDE then submits this information to the federal government once it combines its data with that from the Chancellor's Office. Therefore, when the Chancellor's Office submits a federal financial status report to the CDE that is not supported by its own accounting records, the CDE may submit an inaccurate federal financial status report to the federal government.

Federal regulations require subrecipients of federal vocational education funds to provide accurate, current, and complete disclosure of the vocational education grant program. In addition, state guidelines require agencies receiving federal funds to reconcile federal financial reports with the official accounting records and retain supporting schedules and work sheets for a minimum of three years. Failure to reconcile federal financial reports with the accounting records can result in misstated claims that are not supported by the department's accounting records and that may go undetected.

Other Instances of Noncompliance With State Requirements

In the following instances, the Chancellor's Office did not comply with certain state requirements.

- The Chancellor's Office receives federal vocational education funds through interagency agreements with CDE. Of the approximately \$59 million in vocational education funds available to it during fiscal year 1994-95, the Chancellor's Office did not spend approximately \$7.1 million. Thus, this \$7.1 million is available for future years as carryover funds. Terms of the interagency agreements require the Chancellor's Office to provide CDE with reasons why it had carryover funds from prior years and its plans to spend these funds. While the Chancellor's Office states that it provided the CDE with

reasons why it had \$7.1 million of carryover funds from fiscal year 1994-95 and its plans to reduce the amount of the carryover, it could not provide us the official transmittal to CDE with this information.

- The Chancellor's Office did not monitor all travel costs reimbursed to community college districts. During our review of agreements for administrative services for certain programs distributed through apportionments, we noted that the Chancellor's Office reimbursed one district approximately \$1,100 for meals at two particular meetings. The average cost per person for meals at one of the meetings was \$11 for breakfast and \$22 for lunch. In total, the charges for the meals at this one meeting exceeded the State's reimbursement rates by approximately \$430. The agreements between the Chancellor's Office and the community college districts specifies that the districts shall be reimbursed according to the State's reimbursement rates of \$5.50 for breakfast and \$9.50 for lunch. We reported this issue in prior years.
- Our review of vocational education expenditures disclosed that the Chancellor's Office did not obtain the proper approval from the Department of General Services (DGS) for a contract amendment. Specifically, the Chancellor's Office amended this contract twice: first to add funding and extend the term, and next to extend the term again. Although it appropriately obtained approval for the first amendment, it did not believe DGS approval was required for the second amendment. However, the second amendment did require approval since it extended the term for more than one year beyond the original end date of the contract. State regulations require that an amendment to a contract that extends the original term beyond one year must have DGS approval. Failure to obtain proper approval on contract amendments puts the State and the contractor at risk if the amendment is subsequently disapproved.
- Financial reports for the General Fund were submitted to the State Controller's Office (SCO) on August 14, 1995, approximately two weeks after the deadline of July 31, 1995. Failure to submit financial statements to the SCO by the deadlines hinders the State's ability to produce and issue its financial statements promptly. We reported this issue in prior years.
- The Chancellor's Office did not submit a plan to the Department of Finance (DOF) explaining how it intended to spend approximately \$726,000 of its DSP&S apportionment funds designated for program development and program evaluation. The Chancellor's Office spent the majority of these funds by June 30, 1995, through apportionments and contracts with community colleges. State law requires the Chancellor's Office to submit an expenditure plan for these funds to the DOF at least 15 days prior to the allocation of those funds.
- Although the Chancellor's Office did complete a physical inventory of property in May 1995, it did not reconcile its physical inventory of property with its accounting records. State regulations require that agencies reconcile their physical property counts with the accounting records at least once every three years. Failure to reconcile physical inventory with accounting records can result in failure to detect loss or theft of state property. We reported this issue in prior years.

- The Chancellor's Office has not taken steps to clear long-standing travel, expense, and salary advances from the revolving fund. As of March 1996, advances that have been outstanding for more than one year totaled more than \$19,000. State regulations require agencies to schedule claims for reimbursement of office revolving funds promptly. We reported this issue in prior years.
- The Chancellor's Office did not submit its Report on Fiscal and Compliance Accountability to the Joint Legislative Audit Committee (JLAC) for fiscal year 1994-95. This report provides certain information regarding audits of community college districts. State law requires the Chancellor's Office to submit this report to JLAC on June 30 of each year. Because the Chancellor's Office did not prepare and submit this report, JLAC was not informed of issues related to audits of community college districts.

Recommendations

To ensure that payroll charges to federal grants are accurate, the Chancellor's Office should develop a labor distribution system that bases payroll charges on actual hours worked.

To improve its control and accountability over funds for its Vocational Education—Basic Grants to States, the Chancellor's Office should take the following steps:

- Request reimbursement based on actual program expenditures; and
- Develop a system to ensure that subrecipients are provided only the funds for their actual, immediate cash needs.

To ensure that community college districts' use of federal and state funds is properly monitored, the Chancellor's Office should do the following:

- Promptly review and follow-up on instances of noncompliance with federal and state laws and regulations noted in audits of community college districts;
- Inform community college districts when it finds that their audit reports do not meet audit standards; and
- Ensure that community college districts have an audit completed and submitted to the Chancellor's Office by December 31 of each year.

To improve its accountability over funds for the matriculation program, the Chancellor's Office should monitor the matriculation participants to ensure they are meeting the matching funds requirement.

To improve its calculations of apportionments, the Chancellor's Office should take the following actions:

- Ensure that it uses correct data when calculating apportionments and verify recalculations to ensure that they are mathematically accurate; and

- Ensure that it includes all applicable factors in the calculation of apportionments and calculates apportionments in accordance with their established formulas.

To ensure that it complies with the reporting requirements for its Vocational Education—Basic Grants to States, the Chancellor’s Office should take the following actions:

- Reconcile its federal financial reports with its official accounting records and maintain documentation of such reconciliations.

To ensure that it complies with state reporting requirements, the Chancellor’s Office should take these steps:

- Provide the CDE with a report explaining the reasons for the carryover of funds and describing its plans to reduce the amount of these carryover funds;
- Submit its financial reports to the SCO in a timely manner;
- Submit its report on Fiscal and Compliance Accountability to JLAC; and
- Submit an expenditure plan to the DOF for all DSP&S program development and program evaluation funds at least 15 days before allocating these funds.

To improve its system of internal controls, the Chancellor’s Office should do the following:

- More closely monitor travel costs incurred under apportionment contracts to ensure that payments do not exceed the State’s reimbursement rates;
- Reconcile its physical inventory of capitalized equipment with its accounting records;
- Obtain proper approval for amendments to contracts; and
- Take the appropriate steps needed to clear long-standing travel, expense, and salary advances from the revolving fund.

Appendix

U.S. Department of Education Grant

<u>Federal Catalog Number</u>	<u>Program Title</u>
84.048	Vocational Education—Basic Grants to States

U.S. Department of Labor Grant

<u>Federal Catalog Number</u>	<u>Program Title</u>
17.250	Job Training Partnership Act

U.S. Department of Health and Human Services Grant

<u>Federal Catalog Number</u>	<u>Program Title</u>
93.561	Job Opportunities and Basic Skills Training

Federal and State Criteria

Cost Principles

The Office of Management and Budget (OMB), Circular No. A-87, Attachment B, Section 11(h), requires that charges to federal grants for employee salaries charged to more than one federal program be supported by activity reports that reflect an after-the-fact distribution of the actual activity of each employee. Further, Section 11(h) also states that budget estimates or other predetermined percentages do not qualify as support for payroll unless adjusted, at least quarterly, to the actual time spent.

Cash Management

The Code of Federal Regulations, Title 31, Section 205.20, requires that federal funds transferred to the State be limited to the actual, immediate cash needed. This section also requires the State to minimize the time between the transfer of federal funds and the disbursement of those funds for program purposes. In addition, the Code of Federal Regulations, Title 34, Section 74.61(e), requires that cash advances to subrecipients conform substantially to the same standards of timing and amount as those that apply to cash advances by federal agencies to primary recipients.

The State Administration Manual, Section 8047, requires state agencies to schedule claims for reimbursement of office revolving funds promptly.

Monitoring

OMB Circular A-128, paragraph 9(c), requires the Chancellor's Office to ensure that community colleges districts take appropriate corrective action within six months after they receive audit reports noting instances of noncompliance with federal laws and regulations.

Further, OMB Circular A-128, paragraph 13(c), states that a separate report should cover all fraud, abuse, or illegal acts or indications of such acts, including all questioned costs as a result of these acts, that the auditors find.

The California Education Code of Regulations, Title 5, Section 59108, requires the Chancellor's Office to monitor the completion of community college district audit reports and ensure that findings are resolved.

The California Code of Regulations, Title 5, Section 59106, requires that, not later than December 31 of each year, an audit report for each district for the preceding fiscal year shall be filed with the Chancellor's Office, the DOF, and other regulatory agencies in accordance with Section 84040.5 of the Education Code.

The California Code of Regulations, Title 5, Section 55518, states that each dollar of state matriculation funding shall be matched by three dollars of other district resources devoted to the matriculation program.

Internal Control

The State Administrative Manual, Section 1247, states, in part, that an amendment to a contract that only extends the "original term" for a period of one year or less is exempt from DGS's approval.

The State Administrative Manual, Section 8652, requires agencies to reconcile their physical property counts with their accounting records at least once every three years.

The agreements between the Chancellor's Office and the community college districts specify that the districts will be reimbursed for travel costs according to the State's reimbursement rates established by the Department of Personnel Administration rules. These rules, described in the California Code of Regulations, Title 2, Section 599.619, state that the maximum reimbursement rates for employees traveling on business are \$5.50 for breakfast and \$9.50 for lunch.

Apportionments

The California Education Code, Section 69648, requires the Chancellor's Office to adopt rules and regulations to implement EOPS programs. The purpose of the EOPS is to encourage enrollment of students with language, social, and economic disadvantages. To comply with these rules and regulations, the Chancellor's Office adopted a formula that allocates a portion of the EOPS funds based upon each college's level of effort. In its formula to determine the level of effort, the Board of Governors includes the most recent final expenditure information available and the allocation amounts that the campuses received for the previous three fiscal years.

The California Education Code, Section 84850, requires the Chancellor's Office to adopt rules and regulations for the administration and funding of educational programs and support services to be provided to disabled students by community college districts. As part of these rules and regulations, the Chancellor's Office adopted a formula for allocating DSP&S funds, which specifies that a portion of DSP&S funds be allocated on the basis of growth in weighted student counts.

Reporting Requirements

The fiscal year 1994-95 Budget Act, Item 6870-101-001, provides funding to the Chancellor's Office for the DSP&S apportionment. Provision 7(a) of this item requires the Chancellor's Office to submit an expenditure plan for the DSP&S funds designated as program development and program evaluation to the DOF at least 15 days before allocating these funds.

The Department of Finance, Management Memo 95-08, states that the year-end financial reports for the General Fund for fiscal 1994-95 are due July 31, 1995.

The California Education Code, Section 84040.6, requires the Chancellor's Office to submit a report to JLAC on June 30 of each year stating (1) the number and nature of audit exceptions and estimated amount of funds involved in the exceptions, (2) a list of districts that failed to file their audits, and (3) the actions taken by the Chancellor's Office to eliminate audit exceptions and comply with management improvement recommendations.

The fiscal year 1994-95 interagency agreement between the Chancellor's Office and the CDE contains several requirements for the Chancellor's Office. Specifically, it requires the Chancellor's Office to provide the CDE with the reasons for any carryover funds from prior year interagency agreements and its plans to reduce the amount of the carryover.

Accounting Records

The Code of Federal Regulations, Title 34, Section 74.61(a), requires grantees to provide accurate, current, and complete disclosure of the Vocational Education grant program. In addition, the State Administrative Manual, Section 20014, requires agencies receiving federal funds to reconcile federal financial reports with the official accounting records and retain supporting schedules and work sheets for a minimum of three years.

California State University Chancellor's Office

We reviewed the financial operations and related internal controls of the California State University Chancellor's Office (CSU Chancellor's Office).

CSU Campuses Incorrectly Accounted for Buildings

The CSU Chancellor's Office does not have procedures to ensure that the costs of buildings are correctly accounted for by the campuses. For example, we found that the CSU Chancellor's Office records indicate that it notified the various campuses of the costs of projects to be recorded in the campuses' building or improvements accounts prior to August 31, 1995, the State Controller's Office deadline for submitting their financial statements. However, some campuses did not include this information on their statements of general fixed assets to the State Controller's Office. As a result, the building accounts as reported to the State Controller's Office for inclusion in the State's financial statements were understated by a total of \$68.6 million.

In addition, we found that one campus reported as general fixed assets approximately \$7.3 million related to a building owned by a proprietary fund. The fixed assets of proprietary funds should be reported in the owner fund's fixed asset account. As a result, the campus overstated its general fixed assets as reported to the State Controller's Office for inclusion in the State's financial statements. State administrative procedures require state agencies to report only the fixed assets of governmental funds in the general fixed assets account group.

The CSU Chancellor's Office Incorrectly Accounted for Construction in Progress

The CSU Chancellor's Office incorrectly accounted for construction costs related to completed projects. Initially, projects in the construction phase should be accounted for as construction in progress in the General Fixed Asset Account Group. When the construction phase ends, the costs should be transferred from the construction in progress account to the building or improvements account. We found that the CSU Chancellor's Office incorrectly accounted for construction costs totaling approximately \$49 million. Specifically, the CSU Chancellor's Office did not reduce its construction in progress account and did not notify the CSU campuses of completed construction of approximately \$48.5 million so that the campuses could record the amounts in their building accounts. In another instance, we found that the CSU Chancellor's Office transferred construction costs totaling \$.6 million from its own account to a campus building account before the construction phase was completed. The CSU Chancellor's Office based its decision on when the funding source was spent or was no longer available for spending. As a result, its construction in progress account was overstated and its building account was understated by approximately \$48 million (net) when these costs were reported to the State Controller's Office for inclusion in the State's financial statements. Further, a delay in transferring the costs from the construction in progress account to the building account delays the reporting of building additions to the Department of General Services for inclusion in the statewide real property inventory.

State administrative procedures state that the construction phase ends when a Notice of Completion is filed with the County Recorder, and that the completion date of any project should also be construed as being the date of final inspection or date of occupancy of the project, whichever is earliest.

Recommendations

To improve its accounting for construction in progress and buildings, the CSU Chancellor's Office should:

- Direct the CSU construction office to inform the CSU Chancellor's Office of the status of construction projects at the end of the fiscal year.
- Reduce its construction in progress account when the construction phase is completed or the building is occupied. Further, the CSU Chancellor's Office should notify the campuses of the completed projects so that the campuses can record the completed projects in their building accounts at the fiscal year end.
- Direct the CSU campuses to report to the State Controller's Office for inclusion in the State's financial statements general fixed assets of governmental funds separately from fixed assets of proprietary funds.

Appendix

State Criteria

Accounting for Property

The State Administrative Manual (SAM), Section 8600 et seq., defines property, including buildings, and outlines the requirements for property reporting. Further, Section 6561 states that the construction phase ends when a Notice of Completion is filed with the County Recorder, and Section 6750 states that the completion date of any project should also be construed as being the date of final inspection or date of occupancy of the project, whichever is earliest.

The SAM, Section 8621, states the accounting rules for governmental funds and proprietary funds. Specifically, property of governmental funds is recorded in the general fixed assets account group while property of proprietary funds is recorded in the owner fund's fixed asset accounts.

THE CALIFORNIA STATE UNIVERSITY

Schedule of Findings and Questioned Costs

Year ended June 30, 1995

SYSTEMWIDE

(1) Third-Party Servicers

Finding

Title IV regulations require, in a contract with an institution and third-party servicer, that the third-party servicer shall include agreements to:

1. Comply with all statutory provisions of or applicable to Title IV of the Higher Education Act (HEA)
2. Refer to the Office of Inspector General of the Department of Education for investigation any information indicating there is reasonable cause to believe that the institution might have engaged in fraud or other criminal misconduct in connection with the institution's administration of any Title IV, HEA program
3. Be jointly and severally liable with the institution to the Secretary for any violation by the servicer of any statutory provision of or applicable to Title IV of the HEA
4. If a servicer or an institution terminates the contract, or if the servicer stops providing services for the administration of a Title IV, HEA program, goes out of business, or files a petition under the Bankruptcy Code, return to the institution all records in the servicer's possession and funds, including Title IV, HEA program funds.

We noted that several campuses utilize a third-party servicer to complete the Student Status Confirmation Reports required by the Federal Stafford Loan Program. The contract between the campuses and the third-party servicer does not appear to contain the contractual requirements set forth above.

Recommendation

We recommend that the California State University seek a modified contract which contains the required clauses. Additionally, as the California State University is jointly and severally liable for errors or violations occurring at the third-party servicer, the California State University should ensure that the third-party servicer satisfies the requirement for annual compliance audits of third-party servicer's operations and compliance with Title IV laws and regulations and should obtain a copy of the audit report at such time that it is available.

Management's Response

The University concurs with the recommendation. Campuses utilizing the services of the National Student Loan Clearinghouse will be advised to amend their contract with the Clearinghouse to include appropriate references to the statutory and regulatory provisions governing third-party servicers for purposes of Federal Title IV student financial aid programs. The revised contract will include reference to the requirement for a compliance audit of third-party servicers and the Clearinghouse's provisions of a copy of the annual audit report to the California State University for all periods covered by the contract.

THE CALIFORNIA STATE UNIVERSITY
Schedule of Findings and Questioned Costs, Continued

(2) EduServ Technologies, Inc. Audit Findings

Billings, collection and due diligence functions of the Federal Perkins Loan Program are performed by EduServ Technologies, Inc. (EduServ). The audit report on EduServ includes certain findings of noncompliance pertaining to services carried out for the California State University. The findings are included below as findings 1 through 7.

Finding #1 at EduServ

First Billing Statement (674.43(a)(1) and (2)(I))

There were 7 occurrences out of a sample size of 47 where the first billing statement was generated less than 30 days prior to the due date. System III interprets 30 days to be equal to 1 month. Accordingly, statements which are due in March are generated less than the required 30 days since February contains only 28 or 29 days. EduServ has initiated a programmatic fix to this date calculation.

Effect on the California State University

EduServ prepares the first billing statement on behalf of the California State University. The amount of loans pertaining to borrowers for whom EduServ should have prepared the first billing statement during the year ended June 30, 1995 was \$13,636,836.

Finding #2 at EduServ

Incorrect Loan Numbers (674.6-17)

Two occurrences out of a sample of 47 were found to have incorrect loan numbers. One occurrence out of the sample was found to have an incorrect Social Security number. These portfolio conversion errors were caused by a keying error during the manual conversion process and have been corrected.

Effect on the California State University

Not applicable, as the instance described above did not pertain to the California State University.

Finding #3 at EduServ

Automatic Loan Write-Off (674.47(g)(1))

An institution may write off a loan in default with a balance of less than \$25, including outstanding principal, accrued interest, collection costs and late charges. EduServ initiated an automated write-off of any loan, in any status, where the loan balance was less than \$.50.

Effect on the California State University

Not applicable as the instance described above did not pertain to the California State University.

THE CALIFORNIA STATE UNIVERSITY
Schedule of Findings and Questioned Costs, Continued

Finding #4 at EduServ

90-Day Grace Period (674.42(4)(b)(2)(i)(a) and (b))

One instance was identified out of a sample size of 47 where the required 90-day grace contact (which reminds the borrower of his or her responsibility to comply with the terms of the loan) was not produced.

Effect on the California State University

Not applicable as the instance described above did not pertain to the California State University.

Finding #5 at EduServ

Collection Costs (674.45(e))

Regulations require schools to assess all reasonable collection costs against the borrower without regard to state law, if the provision is included in the promissory note. Between July 1, 1981 and July 1987, the promissory note used by the institution may have been restricted to 25% the collection costs that may be assessed against borrowers.

The school determines what collection costs are "reasonable," as long as they are based on either actual costs that the school incurs for each borrower or on average costs incurred in collecting loans in similar stages of delinquency.

One occurrence out of a sample 47 was identified where the borrower was assessed an incorrect collection fee amount through a keying error. As a result of this finding, EduServ has "reversed" the incorrect collection fee assessment.

Effect on the California State University

Not applicable as the instance described above did not pertain to the California State University.

Finding #6 at EduServ

Late Charges (674.43(b)(2)(i))

The regulations require that an institution assess a late charge for loans made for periods of enrollment beginning on or after January 1, 1986, during the period in which the institution attempts to secure any part of an installment payment not made when due.

Eleven occurrences out of sample size of 47 were found where the late charge assessment was not made for the month of April. This condition was identified during last year's compliance test. EduServ is currently working to eliminate the programmatic cause of this condition.

Effect on the California State University

EduServ performs this function on behalf of the California State University. The amount of loans at June 30, 1995 pertaining to borrowers for which late charges should have been assessed totaled \$15,305,953.

THE CALIFORNIA STATE UNIVERSITY
Schedule of Findings and Questioned Costs, Continued

Finding #7 at EduServ

90-Day Telephone Call (674.43(f))

According to regulations, if a borrower does not respond to a Final Demand letter within 30 days from the date it was sent, the institution must attempt to contact the borrower by telephone before beginning the collection procedures.

One instance was identified where the required 90-day telephone call was not made.

Effect on the California State University

Not applicable as the instance described above did not pertain to the California State University.

CALIFORNIA STATE UNIVERSITY, BAKERSFIELD

(1) Financial Reporting – FISAP Report

Finding

In reviewing the Fiscal Operations Report (FISAP) for the year ended June 30, 1995, we noted that administrative costs of \$17,034 as reported in the FISAP do not agree to administrative costs of \$13,794 recorded in the general ledger.

Recommendation

The FISAP, as well as other Federal reports containing financial information, is required to be based upon the University's accounting system. We recommend that the University implement a more thorough review process in order to ensure reporting of accurate, system-based accounting information in Federal financial reports.

Campus Management Response

The error in calculating administrative costs was discovered and correcting entries were made subsequent to year-end general ledger processing. The FISAP totals were reported to reflect the corrected amount of administrative costs claimed for the 1994-95 academic year. This was a one-time occurrence. The accounting procedures have been modified to help ensure that this type of error does not occur in the future.

(2) Federal Funds Matching Requirement for Federal Perkins Loan Program

Finding

The Higher Education Act (20 U.S.C. 1087cc) and implementing regulations (34 CFR 674.8) require the University to provide an Institutional Capital Contribution (ICC) of one-third of the Federal Capital Contribution (FCC), or 25% of the combined FCC and ICC for the Perkins Loan Program during the 1994-95 and succeeding award years. This requirement is also reflected in the 1994-95 Federal Student Financial Aid Handbook published for the Department of Education.

THE CALIFORNIA STATE UNIVERSITY

Schedule of Findings and Questioned Costs, Continued

During financial aid matching test work, we noted that for the Perkins Loan Program, the University used a matching percentage of 15% in calculating the 1994-95 ICC. This percentage was the Federal requirement for fiscal year 1993-94. Per discussion with University personnel, the University was unaware of the change in the matching percentage for 1994-95 and, thus, continued to use the 1993-94 matching percentage. This resulted in an institutional under-capitalization of \$316.

Recommendation

We recommend that the University enhance the existing procedures regarding implementation of new or revised Federal requirements such that employees are aware of current Federal requirements in administering Federal grant activities.

Campus Management Response

Procedures have been implemented to ensure that new or revised Federal requirements are reviewed in a timely manner by all departments and/or personnel affected by the regulations and appropriate steps are taken to ensure compliance.

The University has historically overmatched Federal Capital Contributions to the Perkins, formerly NDSL, Program; therefore, cumulative institutional matching funds were not deficient. Through June 30, 1994, the University's cumulative overmatching totaled \$30,378.

(3) Student Financial Aid File Maintenance

Finding

Title IV regulations (34 CFR 668.55) require that institutions verify the student's financial information as reported on the Student Aid Report (SAR). Updates and/or changes in student financial information must be entered into the institution's financial aid system such that current, as well as accurate, student information is maintained in the student's file along with documentation of any changes and the effect such a change will have on the student's financial aid award.

In performing financial aid file completeness test work, we noted that one out of six students selected had submitted updated financial information, which had not been reflected in the system. While the student's financial information was not current in the system, this particular change would not have affected the student's financial aid award.

Recommendation

We recommend that the University enhance the existing procedures to ensure that changes in student information are adequately documented within the student's file as well as input into the system on a timely basis regardless of whether or not the change will affect the student's financial aid award. This will ensure that up-to-date information is being used in the student's award calculation.

THE CALIFORNIA STATE UNIVERSITY

Schedule of Findings and Questioned Costs, Continued

Campus Management Response

The University makes every effort to ensure that data used in the SCT Banner Student Aid Management System (Banner System) accurately reflects verification data supplied by students, parents and all appropriate outside agencies. For this particular student, updated information had been received with regards to family size. Family size was not changed in the system because, given the income of the parents, the calculated expected family contribution was zero with either a family size of three (as originally reported) or four (updated information), which was demonstrated during the audit process. As this change did not produce a change in eligibility or award amount, the Financial Aid Counselor assigned to that particular student file did not feel that it was necessary to take additional time to change data which was not required.

Although expediency is certainly important in the processing of financial aid applications, the University will make an effort to ensure that decisions and the reasons underlying those decisions are more fully documented in the student's financial aid file or in the electronic notation area of the Banner System.

CALIFORNIA STATE UNIVERSITY, DOMINGUEZ HILLS

(1) Student Status Confirmation Reports

Finding

Student Status Confirmation Reports (SSCR) received from guarantee agencies must be completed and submitted within 30 days of receipt to the guarantee agency (34 CFR 682.610). The receipt date for one report received during the 1994-1995 academic year could not be determined.

Recommendation

We recommend that the University monitor the receipt and filing of the SSCR to assure compliance with Federal reporting requirements.

Campus Management Response

The University concurs with the finding and recommendation. The SSCR that was received with the indeterminable date was processed during a transitional period in the Registrar's Office. The staff member who is responsible for processing of the SSCR has now been trained. The Financial Aid Office has begun enforcing the stamping of the SSCR with the receipt date before turning the report over to the Registrar's Office for processing. In addition, a review procedure is being implemented to ensure proper receipt and return date documentation, including the Financial Aid Office receiving, from the Registrar, a copy of the document which indicates the actual date of submission and evidence of the Registrar's certification.

THE CALIFORNIA STATE UNIVERSITY
Schedule of Findings and Questioned Costs, Continued

CALIFORNIA STATE UNIVERSITY, LONG BEACH

(1) Federal Cash Transaction Reports

Finding

Recipients of Federal funding from the Department of Education (DOE) are required to complete a reconciliation of the Federal Cash Transactions (PMS 272) to the general ledger on a monthly basis and return the form to the DOE.

California State University, Long Beach (CSULB) has complied with the monthly reporting requirement but has not reconciled the cash balances reported to DOE on form PMS 272 to the general ledger.

Recommendation

We recommend that the reconciliations in future periods be prepared and adjustments recorded so as to accurately reflect general ledger balances.

Campus Management Response

We agree with the finding and will attempt to ensure compliance for subsequent reporting periods. Reconciliations had been prepared in previous years; however, during the 1994-95 fiscal year, the business office experienced a significant staff turnover (50%), and accordingly, preparing the subject reconciliation did not have the highest priority in comparison to the day-to-day operations.

(2) Exit interviews

Finding

Title IV regulations (34 CFR 682.604) require that Stafford loan recipients receive an exit interview prior to the graduation or withdrawal from an institution. We noted through specific file test work that one student who had graduated did not receive exit interview information.

Recommendation

We recommend that the University continue to monitor student enrollment status so that students withdrawing or graduating from the University attend an exit interview or are sent the required interview documents on a timely basis.

Campus Management Response

Considerable effort has been put into identifying students graduating or leaving the University. In some cases, however, action on a student's graduation may be taken after the reports have been created identifying students who are graduating or leaving CSULB. In the next cycle, the student would be identified and included in the group advised of the exit interview requirement and mailed the required information. The audit sample was pulled prior to the exit interview cycle for Fall 1995.

THE CALIFORNIA STATE UNIVERSITY
Schedule of Findings and Questioned Costs, Continued

Exit interview materials have been mailed to the student identified as not having attended the exit interview. Another review of the criteria used to identify students for whom the exit interview is necessary is required.

(3) Refunds

Finding

Title IV regulations (34 CFR 682.60) require institutions to refund allocated portions of loans to lending institutions within 60 days of being notified by a student of a withdrawal. We selected a sample of eight students to test compliance with this requirement, and determined that all of the sampled students' refunds were submitted to the lending institutions after the 60-day period following the students' withdrawal.

Recommendation

We recommend that the University assign one person the responsibility to assure all refunds are remitted to lending institutions on a timely basis, and to assign that person the authority to delegate refund procedures to the appropriate number of associates to balance the required workload.

Campus Management Response

Financial Aid staff and Financial Aid Business Office staff are reviewing current refund procedures to determine the most appropriate individual to be assigned the responsibility for routine processing of the refunds. The result will be one individual with primary responsibility for refund processing and for returning funds to lenders.

In addition, staff have begun another review of the options available for automating the full refund process from the time fees are refunded to the student's account until the appropriate amount is refunded to the lender or the Federal account.

CALIFORNIA STATE UNIVERSITY, NORTHRIDGE

(1) Federal Funds Cash Management

Finding

Recipients of Federal funds are required to place such funds in interest-bearing accounts. During the year ended June 30, 1995, California State University, Northridge (CSUN) had placed only a portion of funds received from the Federal Emergency Management Agency (FEMA) in interest-bearing accounts. Interest earnings foregone as a result of not investing such funds totaled approximately \$187,000 for the year ended June 30, 1995, assuming rates of return ranging from 4.96% to 5.98%.

Recommendation

We recommend that CSUN place all Federal funds in interest-bearing accounts to be in compliance with Federal regulations. We understand that beginning in September 1995, Federal funds have been placed in interest-bearing accounts.

THE CALIFORNIA STATE UNIVERSITY

Schedule of Findings and Questioned Costs, Continued

Campus Management Response

CSUN agrees with this recommendation. As of September 1995, temporary cash balances of FEMA funds have been invested in the State of California Local Agency Investment Fund. Procedures have been established to invest all FEMA cash as soon as it is received by the campus.

(2) Invoice Approvals

Finding

CSUN has established a Disaster Cost Recovery Office (DCRO) that manages the recovery efforts of CSUN from the January 1994 earthquake. An important function of this office is to ensure that all earthquake-related expenditures which are being reimbursed by FEMA are allowable under Federal guidelines and include proper supporting documentation. The DCRO indicates approval of such invoices prior to the payment by the accounts payable office. During our internal control test work over expenditures, we noted that two invoices, while not considered unallowable expenditures, were paid from accounts payable without the approval of the DCRO.

Recommendation

We recommend that the DCRO review and approve for payment all earthquake-related invoices that are to be reimbursed by FEMA.

Campus Management Response

CSUN agrees with this recommendation. Procedures are in place, and staff has been properly trained to ensure appropriate review and approval of earthquake-related invoices prior to processing vendor payments.

SAN JOSE STATE UNIVERSITY

(1) Cost of Attendance Calculation

Finding

Institutions should take into account whether students are enrolled on a full-time or less than full-time basis when determining the cost of attendance in the need calculation. In addition, the institution is required to develop an adequate system to ensure the consistency of information related to a student's application.

The need calculation for one student in our sample who was enrolled on a half-time basis during the Spring of 1995 had allowable budgeted costs which included enrollment fees for full-time attendance.

THE CALIFORNIA STATE UNIVERSITY

Schedule of Findings and Questioned Costs, Continued

Recommendation

Although the student file identified above did not show documentation for less than full-time budgeted costs in the need determination, the resultant award was properly calculated. We recommend that the University comply with the regulation which requires that the budget used in the need analysis calculations is to reflect the costs appropriate to the student's enrollment status.

Campus Management Response

The University concurs with the recommendation and will instruct counselors to change the cost of attendance figures when appropriate.

SAN FRANCISCO STATE UNIVERSITY

(1) Physical Inventories

Finding

OMB Circular A-21 Section J-12 states "Charges for use allowances or depreciation must be supported by adequate property records, and physical inventories must be taken every two years to ensure that the assets exist and are usable, used and needed." Additionally, OMB Circular A-110 requires that a physical inventory of equipment be taken every two years for equipment acquired with Federal funds and Federally owned equipment. We noted that the campus performs physical inventories once every three years.

Recommendation

We recommend that the schedule for taking of physical inventories be modified to comply with Federal regulations.

Campus Management Response

The University concurs with the recommendation. As an agency of the State of California, San Francisco State University has been following the property management guidelines of the State Administrative Manual which require a three-year cycle for taking physical inventories. The University will make every effort to move to a two-year physical inventory schedule for all equipment and will continue its current practice of performing inventories on Federally funded equipment every two years. The complete conversion from a three- to a two-year inventory cycle will require the allocation of significant ongoing financial resources by the University. The success of the conversion is somewhat dependent on the identification of these resources.

THE CALIFORNIA STATE UNIVERSITY
Schedule of Findings and Questioned Costs, Continued

**CALIFORNIA POLYTECHNIC
STATE UNIVERSITY, SAN LUIS OBISPO**

(1) Financial Reporting

Finding

In reviewing the Federal Cash Transactions Report (Report SF 272 and SF 272A) for the year ended June 30, 1995, we noted that the ending cash balance per the report did not agree with the balance per the University's general ledger. We noted that while the cash disbursement and receipt activity for the year per the report agrees to the general ledger, the ending cash balance per the report has not agreed to the general ledger for several years. Per discussion with University personnel, this unreconciled difference between the report and the general ledger has existed since the Department of Education (DOE) took over this reporting function. This situation was also noted at other CSU campuses.

Recommendation

With the assistance of the DOE, the University should reconcile the cash balance per the Federal Cash Transaction Report to the University's general ledger through review of prior year records and make the necessary changes to correct the report.

Campus Management Response

The University concurs with the finding and recommendation. As noted, the difference has existed since the DOE took over this reporting function. We have attempted to resolve this difference in the past but the cash transaction report provided by the DOE contained entries that had been blacked out, and we were not able to completely resolve the difference. We continue to reconcile current transactions and to resolve any differences relating to current amounts. We will obtain a copy of the Federal Cash Transaction Report, as suggested, and prepare a reconciliation of the ending cash balance.

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

(1) Exit Interviews

Finding

During our test work, we noted 1 instance from a sample of 13 where a student was not given a Stafford exit interview when required and no attempt was made to contact the student. Federal regulations (34 CFR 682.604) require that a Stafford exit interview be conducted when a student drops below half-time enrollment. If the student drops out without notifying the school, exit interview materials must be sent to the student within 30 days (Federal Student Financial Aid Handbook 1994-1995, 10-113).

Recommendation

We recommend that the University continue to monitor student enrollment status so that students withdrawing or graduating from the University attend an exit interview or are sent the required interview documents on a timely basis.

THE CALIFORNIA STATE UNIVERSITY

Schedule of Findings and Questioned Costs, Continued

Campus Management Response

The University concurs with the finding that in one instance the University did not conduct a Stafford loan exit interview.

Financial Aid Accounting has set procedures for conducting exit interviews. However, as noted in the audit finding, the University did not comply in one instance. Human error accounted for the initial failure to send an exit interview form. In addition, later reports did not list the student as needing an exit interview. Under normal circumstances, the student would have been discovered in the Fall 1995 exit report; however, he had returned to the University and is currently enrolled. The University has investigated the problem with the Computing Services department and believes the issue to be resolved. The University intends to remedy this situation by carefully reviewing every exit and withdrawal report and confirming that all students on each report have been contacted regarding an exit interview.

CALIFORNIA STATE UNIVERSITY, SAN BERNARDINO

(1) Timeframe for Return of Federal Funds

Finding

Title IV (34 CFR 668.22) regulations require institutions to refund Federal Pell grant funds within 30 days of being notified by a student of a withdrawal. During our performance of compliance test work on Pell grant expenditures, we noted that one refund, in a sample of three Federal refunds, was not returned within 30 days of the date that the student officially withdrew.

Recommendation

In order to be in compliance with Federal guidelines, we recommend that the institution implement procedures to ensure that the Federal funds are returned within the required timeframe. Such procedures could include periodically obtaining drop lists from the Accounting Office and assigning one person the responsibility of ensuring that all Federal refunds are remitted on a timely basis and assigning that person the authority to delegate refund procedures to the appropriate number of associates to balance the required workload.

Campus Management Response

The University concurs with the finding and recommendation. Weekly drop lists are now provided by the Accounting Office to the Financial Aid Office. This new procedure should eliminate delays in calculating refunds and remitting refunds, where appropriate, to Federal funds on a timely basis.

(2) Pro rata Refund Calculation

Finding

Title IV regulations (34 CFR 668.22) require that an institution have a "fair and equitable" refund policy that provides for a refund of at least the larger of the amount provided by: (1) State law, (2) the standards established by the school's nationally recognized accrediting agency and approved by the Secretary of the Department of Education or (3) the "pro rata"

THE CALIFORNIA STATE UNIVERSITY

Schedule of Findings and Questioned Costs, Continued

refund calculation. A pro rata refund calculation is required for all first-time students who withdraw from classes before the term is 60% complete. During our audit, we noted that California State University, San Bernardino (CSUSB) did not perform the pro rata refund calculation during the fall quarter of the 1994-95 award year for first-time students. However, we did note that CSUSB subsequently added the pro rata refund calculation as required.

Recommendation

In order to ensure compliance with Federal regulations and to ensure that students who withdraw receive the refund which is most "fair and equitable," CSUSB should perform the pro rata refund calculation when required and remit refunds as appropriate to these students in accordance with the 1995-96 Refund and Repayment Policy. Additionally, CSUSB could require that all refund calculations be reviewed and approved by a designated supervisor to help ensure that the refund is appropriately calculated and that refund policies are being correctly interpreted and applied.

Campus Management Response

The University concurs with the finding and recommendation. While CSUSB's 1994-95 refund policy did make reference to the pro rata refund for first-time students, the appropriate calculation was not completed for students who withdrew during the fall quarter of 1994. This situation was prompted by a campus concern with the apparent conflict between the institutional refund policy, which limited refunds to the first 14 days following the first date of classes, and the Federal policy requiring a refund up to a point where 60% of the term had elapsed. According to campus records, this window of time was from October 7, 1994 through October 31, 1994.

If a student withdrew by the institutional refund deadline date, October 6, 1994, according to the institutional policy the student received a 100% refund, which exceeds the Federal pro rata calculation. First-time students who withdrew after October 6 but before October 31, would have been subject to the pro rata refund calculation. The campus research has been unable to find any Title IV aid recipients who met the criteria for a pro rata refund during this period. Subsequent to the fall quarter of 1994, CSUSB fully implemented the pro rata refund provision and adhered to that policy.

California Postsecondary Education Commission

We reviewed the California Postsecondary Education Commission's (commission) administration of the U.S. Department of Education grant, Federal Catalog No. 84.164.

Instances of Noncompliance With Federal and State Requirements

In the following instances, the commission did not comply with certain federal or state requirements.

The Commission Did Not Adequately Monitor Subgrantees

Federal regulations require that the commission monitor grant activities to ensure that subgrantees comply with applicable requirements. The commission monitors subgrantees by reviewing periodic status reports, conducting on-site visits, and obtaining and reviewing audit reports from subgrantees. Our review of the commission's files for 15 subgrantees revealed the following:

- None of the files contained copies of audit reports of the subgrantees;
- One file lacked evidence to demonstrate that the commission conducted an on-site visit;
- Four files did not contain a final status report;
- Three files did not contain interim status reports;
- Two subgrantees submitted their interim status reports late; and
- We could not verify the receipt date for interim status reports received from two subgrantees.

In response to our audit report for fiscal year 1993-94, the commission established a policy requiring subgrantees to submit copies of audit reports directly to the commission. However, because the commission did not issue federal funds to new subgrantees during fiscal year 1994-95, it has not yet implemented this policy.

Recommendations

To improve its monitoring of subgrantees, the commission should:

- Ensure that subgrantees submit required interim status reports and final status reports by their due dates; and
- Conduct on-site visits of subgrantees.

Appendix

U.S. Department of Education Grant

<u>Federal Catalog Number</u>	<u>Program Title</u>
84.164	Eisenhower Mathematics and Science Education—State Grants

Federal and State Criteria

The Code of Federal Regulations, Title 34, Section 80.40(a), requires grantees to monitor grant activities to ensure that subgrantees comply with applicable federal regulations and that they achieve performance goals.

The Office of Management and Budget's Circulars A-128 and A-133 require grant recipients that receive federal assistance and provide \$25,000 or more during its fiscal year to a subgrantee to, among other things:

- Ensure that subgrantees meet the audit requirements of the applicable circular;
- Ensure that appropriate corrective action is taken within six months after receipt of the audit report when instances of noncompliance with federal laws and regulations are identified; and
- Consider whether issues in subgrantee audit reports require adjustment of the grantee's records.

Further, A-128 requires grant recipients to determine whether subgrantees spent federal funds in accordance with applicable laws and regulations.

The commission's monitoring of subgrantees consists of:

- Reviewing periodic status reports submitted to it by subgrantees. Interim status reports covering the previous October 1 through April 30 are due May 30 each year. Final status reports covering the previous October 1 through September 30 are due November 30 each year.
- Conducting on-site visits of subgrantees. The commission conducts on-site visits to ensure that grantees are making progress toward the agreed-upon goals. The visits are not intended to be a federal compliance review.
- Obtaining and reviewing audit reports of subgrantees.

California Student Aid Commission

We reviewed the California Student Aid Commission's (commission) administration of the U.S. Department of Education grant, Federal Catalog No. 84.032.

Issue Reported in Prior Years

The following item was reported in previous years and due to its significance warrants corrective action by the commission.

Student Loans Exceeded Allowable Limits

As we reported in five previous years, the commission is not fully complying with the terms of one of its agreements with the federal government to participate in the Federal Family Education Loan programs grant. Under the terms of this agreement, the commission stated that it would not guarantee loans in excess of specified maximum amounts. We tested 45 student loans selected from the commission's database and found that the commission guaranteed 3 Subsidized Stafford Student Loans in excess of the allowable maximum loan amounts.

Federal law allows graduate and undergraduate students to have up to \$65,500 and \$23,000, respectively, in total Subsidized Stafford Student Loans outstanding. However, for two graduate student loans, the commission guaranteed loans that exceeded the maximum loan limit of \$65,500 by \$6,228 and by \$3,245, respectively. In another instance, the commission guaranteed an undergraduate student loan that exceeded the maximum loan limit of \$23,000 by \$2,655. These errors occurred because the commission did not ensure that its computer system contained the proper edits to limit the amount of a student's outstanding Subsidized Stafford Student Loans. The three loans that exceeded the loan limits were guaranteed before April 1995 and, according to a commission official, it corrected this problem in April 1995.

Noncompliance with federal loan limits could result in a loss of state funds if the borrower defaults. This is because in a default situation, the State will pay the lender for the defaulted loan, and in turn, the federal government will reimburse the State the amount it paid the lender. However, the federal government may not reimburse the State for the portion of the loan that exceeded the amount authorized by regulations.

Other Instances of Noncompliance With Federal Requirements

In the following instance, the commission did not comply with various federal requirements.

Late Reporting of Collections to the Federal Government

- The commission hires collection agencies to assist in the collection of defaulted student loans. When funds are collected, the collection agencies remit the money to the commission. The federal government is entitled to receive a share of these monies. Federal regulations require the commission to report to the federal government its share of borrower payments for defaulted student loans and remit their share within 45 days

of receipt of funds from the borrower. However, the commission did not report approximately \$25.2 million (33 percent) of the collections due to the federal government for fiscal year 1994-95 within the required 45 days. Although approximately \$21 million of these collections were no more than one month late, over \$22,000 of the collections were more than one year late. We have reported this issue in prior years.

Recommendations

To improve its administration of federally guaranteed student loans, the commission should:

- Ensure that the computer system's edits are kept current and accurate so that borrowers are not guaranteed student loans that exceed maximum allowable loan limits.

To ensure that it complies with federal reporting requirements for its Federal Family Education Loan program, the commission should:

- Minimize the time lapsed between receipt of collections by the collection agencies and reporting those collections to the United States Department of Education on the monthly claims and collections report.

Appendix

U.S. Department of Education Grant

<u>Federal Catalog Number</u>	<u>Program Title</u>
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84.032

Federal Family Education Loan

Federal Criteria

Program Administration Requirements

The Code of Federal Regulations (CFR), Title 34, Section 682.400, states that, in order for the commission to participate in the Federal Family Education Loan programs, it must enter into various agreements with the federal government. As part of these agreements, the commission agreed that it will ensure that its loan guarantee program meets the requirement that the total amount of student loans made to each borrower would not exceed specified limits.

The United States Code, Title 20, Section 1078(b)(1)(B), provides for specific aggregate loan limits for guaranteeing Stafford loans. These limits are based on the student's grade level and the student's total outstanding loan amounts for the Stafford loan program.

Reporting Requirement

The CFR, Title 34, Section 682.404(g)(3), requires the commission to submit the federal share of borrower

California Department of Education

We reviewed the financial operations and related internal controls of the California Department of Education (department) and the department's administration of the U.S. Department of Agriculture grants, Federal Catalog Nos. 10.550, 10.553, 10.555, and 10.558; the U.S. Department of Labor grant, Federal Catalog No. 17.250; the U.S. Department of Education grants, Federal Catalog Nos. 84.002, 84.010, 84.011, 84.027, 84.048, 84.151, 84.164, 84.173, and 84.186; and the U.S. Department of Health and Human Services grants, Federal Catalog Nos. 93.574 and 93.575.

Summary

We reviewed the financial operations and related internal controls of the department, and the department's administration of U.S. Department of Education, U.S. Department of Agriculture, U.S. Department of Labor, and U.S. Department of Health and Human Services grants. We noted the following:

- The department incorrectly calculated the fiscal year 1994-95 apportionment of Economic Impact Aid (EIA) to school districts. Although it apportioned the correct total amount to school districts statewide, the department apportioned more than its actual entitlements to some school districts and less than its actual entitlements to other school districts.
- The department reimbursed the Department of Youth Authority (DYA) over \$66,000 more for equipment costs for the Adult Education—State Administered Basic Grant program for fiscal year 1994-95 than it originally authorized in its interagency agreement. Although the department had authorized only \$35,000 for the purchase of equipment, the DYA expended over \$101,000 and the department reimbursed the full amount.
- The department did not perform an administrative review of some of its Child and Adult Care Food Program sponsors within the time period prescribed by federal regulations.
- The department submitted inaccurate cash management information to the Department of Finance (DOF). As a result, the DOF's calculation of the State's interest liability was incorrect.
- The department reported inaccurate expenditure data to the California Department of Social Services (DSS) for the Child Care for Families At-Risk of Welfare Dependency program. Because of the incorrect data, the DSS annual report of expenditures from nonfederal sources for all child care programs administered by the State for the fiscal year ending October 31, 1992, was overstated by approximately \$31.6 million and for the fiscal year ending October 31, 1993, was overstated by \$35.4 million.

The Department Calculated EIA Apportionments Incorrectly

The department incorrectly calculated the fiscal year 1994-95 EIA apportionments to individual school districts. It computes the apportionments based on a moving average of ethnicity,

poverty, and transiency ratios for the current year and the two prior years. However, for the fiscal year 1994-95 apportionment, the department used data from only one prior year and included the current year data twice. As a result, the department apportioned incorrect amounts to all school districts that received an EIA apportionment.

Although the department apportioned the correct total amount of EIA funds, it apportioned more than the correct entitlement to some school districts and less than the correct entitlement to other school districts. For example, it apportioned approximately \$14,000 more to the school districts in Alameda County than their collective entitlement. Conversely, the department apportioned approximately \$52,000 less to the school districts in Los Angeles County than their collective entitlement.

Based on our finding, the department adjusted each school district's 1995-96 entitlement.

State administrative procedures require the State Superintendent of Schools to calculate the EIA apportionment to eligible school districts. State law requires agencies to have a satisfactory system of internal accounting and administrative controls to check the accuracy and reliability of accounting data, including an effective system of internal review.

The Department Reimbursed Unallowable Expenditures for the Adult Education—State Administered Basic Grant Program

The department reimbursed the DYA over \$66,000 more for equipment for the Adult Education—State Administered Basic Grant program for fiscal year 1994-95 than it originally authorized in the interagency agreement.

The program funded the agreement with DYA for expenditures of up to approximately \$148,000 to provide adult basic education to wards in its facilities. Specific costs funded under the agreement include approximately \$113,000 for staff salaries, staff benefits, and operating costs. In addition, the agreement allowed the DYA to expend \$35,000 to purchase computers and other specified equipment. However, the department reimbursed DYA over \$101,000 for equipment, which is almost three times the \$35,000 amount allowed. This occurred because the department failed to follow its normal claim approval procedure, which requires the program consultant to review and approve the DYA expenditure reports.

Because the department paid DYA without first amending the agreement, it did not follow the State's disbursement procedures. Further, this violates federal guidelines that require that costs charged to the grant be consistent with the policies, procedures, and regulations that govern the State's own expenditures. Federal Guidelines require that costs charged to federal assistance programs be properly authorized and reasonable to be allowable.

The Department Did Not Perform an Administrative Review of a Child and Adult Care Food Program Sponsor

Our review of a sample of 11 of the 254 Child and Adult Care Food Program sponsors that the department should have reviewed in fiscal year 1994-95 showed that it did not perform the required administrative review at one child care center within the time period specified by federal guidelines. Our review of the regional workload tracking report that lists the

254 sponsors the department should have reviewed in that fiscal year revealed that it did not perform timely reviews at two other child care centers and one day care center. Subsequent information revealed that both child care centers dropped from the program and did not require reviews and that the day care center was reviewed within the prescribed time period. However, this information was absent from the Child Nutrition Food Distribution Division's database, leading to an inaccurate workload tracking report. The major objectives of the department's administrative reviews of the Child and Adult Care Food Program sponsors are to provide sufficient training and technical assistance to these institutions and to monitor performance to ensure effective operation of the program. If the department does not perform administrative reviews when required, it may fail to detect and correct deficiencies in some sponsors' operations. Lack of an accurate tracking report may impact the department's ability to efficiently monitor the program.

The Department Submitted Inaccurate Cash Management Information to the Department of Finance

The Cash Management Improvement Act (CMIA) of 1990 requires the U.S. Department of Treasury and the State to enter into a Treasury-State agreement that establishes procedures for ensuring greater equity, efficiency, and effectiveness in the exchange of funds between the State and federal government. The DOF is responsible for implementing the State's procedures for tracking and calculating state and federal interest liabilities for federal programs. Departments administering federal programs submit information to the DOF on the transfer of funds to the federal government and other information needed to calculate federal or state interest liability.

For fiscal year 1994-95, the department submitted information related to 12 federal programs it administers that fall under the CMIA for the calculation of the state or federal interest liability. However, we found certain errors and omissions in the information that the department submitted to the DOF. Specifically, we found that:

- The department did not always report the correct amount of federal funds transferred to it. We reviewed 165 of the 444 transfers that the department reported to the DOF and found that it sometimes reported incorrect amounts. For example, in the report for two federal programs, the department omitted 29 transfers of funds amounting to approximately \$7 million. Also, the department reported incorrect amounts for 3 transfers in four federal programs resulting in a net understatement of transfers of approximately \$2.5 million. The total of all these reporting errors amounts to an understatement of transfers of approximately \$9.5 million out of a total transfer of approximately \$2.2 billion from the federal government to the State. As a result, the DOF's calculation of the State's interest liability was understated.
- In three federal program reports between January and June 1995, the department reported incorrect numbers of days that the State held federal funds in a state account. As a result, the DOF's calculation of the State's interest liability was overstated.

State and federal regulations require the department to provide accurate and complete information to comply with the federal CMIA.

The Department Inaccurately Reported the Expenditures of Child Care for Families At-Risk of Welfare Dependency Funds

The department prepares an expenditure report for the Child Care for Families At-Risk of Welfare Dependency and submits it to the DSS. The DSS forwards the data to the federal government in its At-Risk Child Care Program Annual Report. This report includes expenditure data for both federal and state funds. The federal government requires this data to determine if the State is making an appropriate financial contribution of state funds to the program. In our review, we found that the department reported greater expenditures than the amounts recorded in its accounting records. This happened because the department compiles the expenditure data from a number of sources, including DSS, a computer database, and its own accounting system. In the process of compiling the data, the department double counted some expenditures, estimated other expenditures when it should have collected actual amounts, and included administrative costs that should not have been included. Because of this compilation error, the DSS reported expenditures from nonfederal sources for all of the State's child care programs for the fiscal year ending October 31, 1992, of approximately \$441.4 million, an overstatement of approximately \$31.6 million. For the fiscal year ending October 31, 1993, the DSS reported expenditures of approximately \$459 million, an overstatement of approximately \$35.4 million. Although the report overstated the expenditure of state funds, the contribution of state funds to this program did not fall below the appropriate amounts. However, inaccurate federal financial reports impact the federal government's ability to monitor the federal program.

Federal regulations require accurate, current, and complete disclosure of the financial results of each program in accordance with the financial requirements of the grant.

Issues Reported in Prior Years

The following is a discussion of issues reported in prior years that appear significant and have not yet been resolved.

Inaccurate Financial Status Report

The department did not accurately report the financial status of the Vocational Education—Basic Grants to States (program) to the federal government. Specifically, the final Financial Status Report for the 1992 grant the department submitted to the U.S. Department of Education overstates the amount of federal and state expenditures for administration. Also, some of the other expenditures the department reported are not recorded in the State's accounting systems.

Federal regulations require accurate, current, and complete disclosure of the financial results of each program in accordance with the financial requirements of the grant. The department jointly administers the program and prepares the State's Financial Status Report, including its own financial data and data that it obtains from the California Community Colleges Chancellor's Office (Chancellor's Office). The department's report overstated the nonfederal share of the Chancellor's Office expenditures for administration by over \$106,000 and the federal share by approximately \$148,000. The department expected to receive data for the period from October 1, 1993, through February 28, 1995. However, the information provided

by the Chancellor's Office was incomplete in that it was current only through December 31, 1994. Before preparing the State's Financial Status Report, the department should have identified that the information from the Chancellor's Office was incomplete.

The department also includes its own expenditure data in the Financial Status Report. The amount of these expenditures is presented by major category of expenditure and subcomponents within each category. However, the department does not maintain its accounting records so that expenditures can be identified by subcomponents.

In preparing its Financial Status Report and reporting expenditures at the subcomponent level, the department must rely on sources of data other than its accounting records. For example, the expenditures it reported for the "Sex Equity Program" subcomponent of the "Other State Administered Programs" major category were taken from one of the department's budget planning documents, which is not a record of actual expenditures.

If the department does not ensure that it obtains current data from the Chancellor's Office, the State's report to the federal government will not be correct. Furthermore, if the State does not identify and record expenditures in its accounting records in the same major category subcomponents required by the Financial Status Report, it cannot be sure that the reported expenditures are accurate. Incorrect financial reports impact the federal government's ability to monitor the federal program.

Late Transfers of SWCAP Recoveries to the State's General Fund

The department did not promptly transfer to the State's General Fund reimbursements representing the federal government's share of the costs of the State's central service agencies. Twelve executive agencies reporting to the governor, as well as the Department of Justice, the Legislature, the Bureau of State Audits, the State Controller's Office, the State Library, and the State Treasurer's Office, provide various central services to state agencies. These entities provide services such as financial, personnel, and legal support. Through the Statewide Cost Allocation Plan (SWCAP), the State recovers the federal government's share of these central service costs. State regulations require the department to transfer all SWCAP costs recovered from the federal government to the State's General Fund within 30 days of the end of each quarter. However, as shown in Table 1, the department was late in making the transfers for the SWCAP recoveries for the four periods that we reviewed.

Table 1***Late Transfers of SWCAP Reimbursements
to the General Fund***

Reporting Period	Estimated SWCAP Amount	Due Date for Transfer	Date that Quarterly Transfer Took Place	Number of Days Late
July-September 1994	\$ 502,024	October 31, 1994	February 2, 1995	94
October-December 1994	430,684	January 31, 1995	September 6, 1995	219
January-March 1995	411,479	May 1, 1995	March 28, 1996	333
April-June 1995	514,577	July 31, 1995	No transfer as of March 31, 1996	245
Total	\$1,858,764			

In its response to our report of this issue in previous years, the department stated that the 30-day requirement is impractical within the California State Accounting and Reporting System. It further stated that the monthly expenditure reports reflecting cost allocation transactions are not available until at least 30 days following the month of service and the recoveries are deposited in its General Fund Clearing Account to help the department with its cash flow problems. However, it took the department 3 months to make the first quarterly transfer and 7 months to make the second quarterly transfer for fiscal year 1994-95. As of March 31, 1996, the department still had not made transfer for the fourth quarter of fiscal year 1994-95. Therefore, the third and fourth quarters are at least 11 and 8 months late, respectively. The Government Code requires the department to transfer SWCAP recoveries to the State's General Fund unless the DOF exempts it from this requirement.

***Inadequate Review of Audit Reports
of Private Nonprofit Agencies***

The department did not ensure that private nonprofit subrecipients that received at least \$25,000 in federal funds during a fiscal year, which includes sponsors of the National School Lunch Program, School Breakfast Program, Child and Adult Care Food Program, and Adult Education—State Administered Basic Grant program, obtained an independent audit as required by federal regulations. The department did not have audit reports for 5 of the 22 subrecipients we reviewed that should have submitted reports within the past two years. Of the 17 audit reports submitted, the department did not review 6 within six months of the date of receipt, as required.

The department requires all subrecipients, regardless of the amount of funds they receive, to submit an annual Audit Status Certification (AASC). The department uses these documents to identify subrecipients that are required to submit audit reports. To determine if the

department properly identified all of the subrecipients that should have submitted audit reports, we reviewed an additional 22 subrecipient files. The department did not have the AASC document for 7 of the additional 22 subrecipients.

Recommendations

To secure compliance with federal regulations, the department should:

- Ensure that costs charged to federal assistance programs, such as the Adult Education—State Administered Basic Grant program, are authorized. In addition, the department should require that the DYA return federal funds it used to purchase equipment in excess of the amount authorized in its interagency agreement;
- Perform administrative reviews of Child and Adult Care Food Program sponsors within the time frame established by federal regulations;
- Review CMIA reports for accuracy and completeness before it submits them to the DOF;
- Prepare accurate, current, and complete financial data for the Child Care for Families At-Risk of Welfare Dependency program and for the Vocational Education—Basic Grants to States;
- Ensure that it identifies all subrecipients that should submit audit reports and that they submit the audit reports when required; and
- Ensure that corrective action is taken within six months after the receipt of the audit report in instances of noncompliance with federal laws and regulations.

To ensure compliance with state regulations, the department should:

- Develop and implement an internal review procedure to ensure accurate calculation of EIA apportionments; and
- Transfer SWCAP reimbursements to the State's General Fund within 30 days of the end of each quarter.

Appendix

U.S. Department of Agriculture Grants

Federal Catalog Number	Program Title
10.550	Food Distribution
10.553	School Breakfast Program
10.555	National School Lunch Program
10.558	Child and Adult Care Food Program

U.S. Department of Labor

Federal Catalog Number	Program Title
17.250	Job Training Partnership Act

U.S. Department of Education

Federal Catalog Number	Program Title
84.002	Adult Education—State Administered Basic Grant Program
84.010	Title I Program to Local Educational Agencies
84.011	Migrant Education—Basic State Grant Program
84.027	Special Education—Grants to States
84.048	Vocational Education—Basic Grants to States
84.151	Chapter 2—State Block Grants
84.164	Eisenhower Mathematics and Sciences Education—State Grants
84.173	Special Education—Preschool Grants
84.186	Safe and Drug-Free Schools—State Grants

U.S. Department of Health and Human Services

Federal Catalog Number	Program Title
93.574	Child Care for Families At-Risk of Welfare Dependency
93.575	Payments to States for Child Care Assistance

Federal and State Criteria

Apportionment

The California Education Code, Sections 54020 through 54033, requires the State Superintendent of Schools to calculate the Economic Impact Aid apportionment to eligible school districts.

Internal Control

The California Government Code, Sections 13402 and 13403, requires agencies to have a satisfactory system of internal accounting and administrative controls to check the accuracy and reliability of accounting data, including an effective system of internal review.

Cost Principles

The Office of Management and Budget (OMB), Circular A-87, Paragraph C et. seq., requires that costs charged to federal assistance programs be authorized or allowable under federal regulations. In addition, OMB Circular A-87 states that for costs to be allowable under a grant, they must be authorized under the state or local laws or regulations. It further states that costs must be consistent with grantees' policies, regulations, and procedures.

Reporting Requirements

The Code of Federal Regulations, Title 45, Section 92.20(b)(1), and Title 34, Section 74.61(a), requires the department to disclose accurate, current, and complete financial results of each program grant in accordance with the financial requirements of the grant.

Cash Management

In the CMIA Implementation Memo, the DOF directed the department to provide accurate and complete CMIA information.

Transfers of SWCAP Recoveries

The California Government Code, Section 13332.01, requires departments to recover SWCAP costs from the federal government. Section 13332.02 of the code requires departments to transfer all funds received from the federal government to the State's General Fund in a manner prescribed by the DOF unless expenditure of the funds is authorized by the DOF. The Government Code also states that if a state department has not transferred funds on a timely basis, the DOF may request the State Controller's Office to transfer the amount that the department should have transferred to the General Fund.

The State Administrative Manual, Section 8755.2, requires departments to transfer SWCAP recoveries to the State's General Fund within 30 days of the end of the quarter.

Monitoring of Subrecipients

The Code of Federal Regulations, Title 7, Section 226.6, requires the department to review the sponsoring organizations of child care centers at least once every four years. It also requires the department to review day care homes with more than 200 sites at least once every two years.

OMB Circular A-133, paragraph 1579, requires subrecipients that receive at least \$25,000 to obtain an audit of their programs at least every two years. Paragraph 1577(b) requires the department to take corrective action within six months in instances of subrecipients' noncompliance with federal laws and regulations.

General Government

Department of Community Services and Development

We reviewed the Department of Community Services and Development's (department) administration of the U.S. Department of Health and Human Services grants, Federal Catalog Nos. 93.568 and 93.569.

Summary

We noted the following concerns during our review of the department's administration of U.S. Department of Health and Human Services grants:

- The department does not have an adequate system for documenting and charging costs to its federal programs.
- The department did not always correctly or completely report information regarding its use of federal funds to the Department of Finance (DOF) for the Community Services Block Grant (CSBG) and Low-Income Home Energy Assistance Program (LIHEAP).
- Service providers that received cash advances from the CSBG program maintained excessive cash balances during fiscal year 1994-95.

The Department Needs To Improve Its Cost Accounting System

The department operates federal programs designed to provide assistance to low income Californians. These programs include the CSBG program, LIHEAP, and several other federal programs. The department needs to maintain an adequate cost accounting system to fairly divide costs, such as payroll and travel expenses, among the federal programs. Its current cost accounting system is flawed, however. We found several significant accounting errors that the department made during the fiscal year 1994-95. Specifically, the department:

- Spent more than it was allowed by federal regulations to administer its LIHEAP;
- Transferred amounts originally charged to one federal grant year back to previous federal grant years for its CSBG program without sufficient documentation;
- Drew federal funds from its CSBG program to pay expenditures for its U.S. Department of Energy Weatherization program; and
- Directed some employees to charge their time to one federal program even though they had not worked on that program but on other federal programs administered by the department.

The department spent more than federal regulations allowed to administer one of its federal programs, the LIHEAP. The department does not monitor its federal grant expenditures during the year by comparing budgeted expenditures to actual amounts expended or by monitoring

account balances to be aware of amounts available for spending. As a result, it exceeded the amount allowed for administrative costs of the LIHEAP by over \$700,000. Its acting fiscal officer stated that the reason for exceeding the allowable limit was that the department charged staff time to LIHEAP that should have been charged to other federal programs. We were not able to validate that this is what occurred because the acting fiscal officer could not provide documentation supporting this contention. Federal regulations require that no more than 10 percent of the LIHEAP funds made available to the State be used for administrative costs.

Also, the department made adjusting entries to its accounting records to transfer costs originally charged to one federal grant year back to the previous federal grant year for its CSBG. The department transferred costs that it had initially charged to its CSBG program for federal fiscal years 1990 through 1994 back to federal fiscal years 1989 through 1993, respectively. The amounts ranged between approximately \$500 from federal fiscal year 1990 to 1989 and \$696,700 from federal fiscal year 1994 to 1993.

Each year the department is allowed to spend 5 percent of the total grant on administrative costs for the CSBG program. However, for fiscal years 1988-89, 1989-90, 1991-92, and 1992-93, it did not spend up to the 5 percent limit. The department recovered these funds by simply transferring expenditures from one grant year to the previous grant year with adjusting entries in the accounting records. The department's policy is to make these types of adjustments to its federal grants twice a year. It only makes such adjustments between two different federal grant years or within the same state fiscal year for the same federal program. However, we were not able to determine the propriety of the department's accounting adjustments to those accounts related to its federal grants because it could not provide supporting documentation for the adjusting entries to its accounting records.

Federal regulations permit the expenditure of the CSBG program funds over 24 months. Federal regulations also require that proper documentation of expenditures must accompany all transactions.

Another weakness we found in the department's cost accounting system was related to the department's withdrawal of \$165,000 from the U.S. Treasury for the CSBG program that was spent for the U.S. Department of Energy Weatherization program. When we asked the acting fiscal officer why this occurred, he told us that the department was attempting to adjust for errors it had made in earlier years in charging department expenditures to the federal programs. The acting fiscal officer told us that between 1989 and 1995 the department erred in the way that it charged expenditures to the federal programs it operates and that a total of \$600,000 of expenditures had been charged in error. In our attempt to review the propriety of these adjustments, we requested to see the documentation supporting the adjustments. However, the department could not provide us such documentation. The acting fiscal officer told us that these records were lost during the latter part of 1995.

Finally, the department directed some of its employees to charge their time to a federal program even though these employees had not worked on the program during the month covered by the time sheets. An employee timekeeping system is an essential component of a department's cost accounting system. An employee who is assigned to work on several federal programs would charge his or her time according to the actual time worked on each program. Proper recording and accounting for each employee's time is important so that each federal program properly bears its fair share of the department's labor and other costs.

For June 1995, the department had employees change their time sheets so that an estimated \$114,000 in employee time was charged to the Earthquake Disaster Assistance program even though the employees had not actually worked on this federal program.

According to the department, it directed its employees to change their time sheets because in fiscal year 1993-94, the department undercharged the Earthquake Disaster Assistance program. The department told us that during that fiscal year, employees actually worked on the Earthquake Disaster Assistance program. However, at the time, the department had not established a cost center for the Earthquake Disaster Assistance program, so the employees could not charge their time to this program. The time they worked on the Earthquake Disaster Assistance program was charged to other federal programs. In June 1995, when the department discovered that it had not charged the Earthquake Disaster Assistance program for all of the costs that it was entitled to charge, the director instructed some of his employees to change their time sheets so that their time would be charged to the Earthquake Disaster Assistance program.

When we discussed this issue with the department in July 1995, it agreed to take steps to correct the errors that had been made in charging employees' time by properly documenting the charges made to the Earthquake Disaster Assistance program. The department provided us with a schedule of employees who had worked on the Earthquake Disaster Assistance program during fiscal year 1993-94. The schedule summarized the program initially charged, hours worked, salary and benefits, and travel expenses. However, the department documented only \$65,000 of the \$114,000. In addition, we found that the schedule was incomplete and inaccurate. Furthermore, the department did not correct its accounting records by posting any journal entries to correct for previous errors and the correcting entry. Unless the department adjusts its records for the actual costs incurred, federal programs may not pay their fair share of those costs. Federal regulations require states to account for grant funds to permit the tracing of funds to a level of expenditures adequate to determine the appropriate use of the funds.

Issues Reported in Prior Years

The following items were reported in previous years and due to their significance warrant corrective action by the department.

The Department Did Not Provide Department of Finance With Accurate Data Regarding Cash Management

The department did not always correctly or completely report information regarding its use of federal funds to the State Department of Finance (DOF) for the CSBG and LIHEAP programs. The DOF uses information submitted by state agencies to calculate a possible interest liability to the federal government. For fiscal year 1994-95, the department reported information on 183 requests for federal funds, 654 claim schedules, 56 payroll transactions, and 40 journal entries. Specifically, the department:

- Incorrectly reported the date by two to three days that the State Controller's Office issued warrants for 1 of 107 claim schedules and two of five payroll transactions that we reviewed;
- Incorrectly reported the date the State received federal funds for one of the 24 drawdown requests that we reviewed;

- Understated the amount paid by a net \$28,000 for 3 of the claim schedules that we reviewed;
- Did not include all of the associated claim schedules in one of the drawdown requests;
- Included too many claim schedules in 2 other drawdown requests; and
- Did not report 2 drawdown requests and 3 claim schedules to the DOF.

The errors in the work sheets sent to the DOF will cause an incorrect calculation of the interest liability to the federal government.

Subrecipients Maintained Excessive Cash Balances

Three of 24 service providers that received cash advances from the CSBG program maintained excessive cash balances for three quarters during fiscal year 1994-95. We defined excessive cash balances to be over 25 percent of the contract amount held at the end of a quarter.

As reported in our management letter for fiscal year 1993-94, the director stated that service providers maintained cash balances of CSBG funds that exceeded 25 percent because Section 12781 of the California Government Code required the department to issue quarterly advances to service providers in an amount equal to 25 percent of the contractor's annual allocation for the contract period. The director further stated that state law did not allow the department to limit cash advances based on the contractor's immediate needs.

Effective July 22, 1995, state law was amended to limit the advance amounts to 25 percent of the contract amount at the inception of the contract and allowing the department to consider service providers' cash on hand when making additional payments. Thus, the department has incorporated the new procedures for fiscal year 1995-96. If the department follows its new procedures, service providers should no longer be allowed to maintain excessive cash balances and the department should be in compliance with federal regulations.

The Department Does Not Comply With Drug-Free Workplace Act

The department is not complying with the Drug-Free Workplace Act (act) in that it does not have an ongoing drug-free awareness program. Federal regulations require that each grantee conduct an ongoing drug-free awareness program. Specifically, the department does not provide follow-up information to employees regarding the hazards of drugs or information regarding the act. Failure to comply with the act could jeopardize future receipt of federal funds.

Terms of the Department's Contracts Were Not Fully Enforced

The department did not fully enforce the terms of its contracts with agencies known as service providers. The department contracts out to provide services under the CSBG program to California residents. Contracts require service providers to complete and submit an expenditure report to the department no later than the 30th day of the month

following each calendar quarter. Of the 54 instances we reviewed, service providers submitted 41 expenditure reports (76 percent) within the required time. Providers submitted 10 expenditure reports (19 percent) late and, as of the conclusion of our audit, had not yet submitted 3 expenditure reports (5 percent). Of the 10 reports that were late, the service providers submitted the reports from 9 to 185 days after the due date. The expenditure reports provide the department with a means to monitor the service providers' cash balances and need for additional cash. Without expenditure reports, the department may advance funds beyond the service providers' immediate cash needs. Beginning in fiscal year 1995-96, the department is changing its procedures for advancing funds to service providers. After the initial quarter's advance, service providers are now required to submit expenditure reports before they can receive additional funds.

The Department Did Not Comply With a State Requirement

The department did not always approve contracts before service providers began providing the specified services. Of the 37 contracts we reviewed, the department did not approve 27 of the contracts until service providers began work. In one instance, the department did not approve the contract until five days after the contract term expired. Prudent business practices dictate that the department approve all contracts before contractors begin work.

Recommendations

To improve its control over program expenditures, the department should:

- Discontinue the practice of transferring expenditures to prior years' allotments and should begin documenting all transactions and accounting adjustments; and
- Implement internal control procedures to ensure compliance with federal statutory requirements.

To improve its compliance with cash management requirements, the department should:

- Follow its new procedure to advance funds subsequent to the initial cash advance only after service providers submit expenditure reports.

To improve its compliance with administrative requirements of federal grants, the department should:

- Establish an ongoing drug-free awareness program; and
- Approve contracts prior to the start of work.

Appendix

U.S. Department of Health and Human Services

<u>Federal Catalog Number</u>	<u>Program Title</u>
93.568	Low-Income Home Energy Assistance Program
93.569	Community Service Block Grant

Federal and State Criteria

Program Requirements

The United States Code Annotated, Title 42, Section 9907(b), states that funds for a fiscal year allotment must be expended in the same or succeeding fiscal year. The Office of Management and Budget "Common Rule" requires states to account for grant funds to permit the tracing of funds to a level of expenditures adequate to determine the appropriate use of the funds.

The United States Code Annotated, Title 42, Section 8624, requires that no more than 10 percent of the LIHEAP funds made available to the State and not transferred may be used for planning and administrative costs.

The California Government Code, Section 1340, requires agencies to maintain an effective system of internal control. The Government Code also requires that the internal control system include recordkeeping procedures sufficient to provide effective accounting control over assets, liabilities, revenue, and expenditures.

The Code of Federal Regulations (CFR), Title 45, Subtitle A, Part 76, Appendix C, requires that each grantee conduct an ongoing drug-free awareness program.

Cash Management

CFR Title 31, Section 205.20, requires that cash advances to a state be limited to the minimum amounts required and be timed to be in accord only with the actual, immediate cash requirements of the state.

The Office of Management and Budget, Circular A-128, requires that cash advances made by the State to service providers or other subrecipients conform substantially to the same standards of timing and amount as apply to cash advances by federal agencies to primary recipients.

CFR Title 31, Section 205.9(f), requires states that do not have a Treasury-State agreement in effect after the later of June 30, 1993, or the last day of the state's 1993 fiscal year, to follow the default provisions prescribed by the federal government.

The Cash Management Improvement Act Default Procedures for the State of California (default procedures) prescribed by the Secretary of the Treasury, U.S. Department of the Treasury, states that the Department of Finance (DOF) is responsible, in part, for maintaining a complete and uniform state accounting system. The default procedures also state that the DOF is responsible for implementing the Cash Management Improvement Act (CMIA).

The DOF requires departments to gather information for calculating the CMIA interest liability. The departments are also required to submit this information to the DOF using the CMIA work sheets.

According to the terms of a contract to provide services to be paid with CSBG funds, service providers are required to complete and submit an expenditure report to the department no later than the thirtieth day of the month following each calendar quarter.

Office of Criminal Justice Planning

We reviewed the Office of Criminal Justice Planning's (office) administration of the U.S. Department of Justice grant, Federal Catalog No. 16.579, and the U.S. Department of Education grant, Federal Catalog No. 84.186.

Summary

We reviewed the office's administration of the federal Drug Control and System Improvement—Formula Grant (DCSI) and the Safe and Drug-Free Schools—State Grant (SDFS). We noted the following concerns during our review:

- The office inappropriately charged the DCSI grant more than \$50,000 in payroll costs for three employees during fiscal year 1994-95. Further, during fiscal year 1993-94, the office inappropriately charged the DCSI grant more than \$11,000 in payroll costs for one of these employees. Charging these costs to the DCSI grant was inappropriate because these employees' services were not related to the DCSI grant.
- The office improperly allocated at least \$38,000 in indirect support costs to only one of its state programs even though these costs benefited all programs, including other state and federal programs. Further, the office overallocated nearly \$27,000 in administrative costs to the DCSI grant because one of the office's cost centers had been omitted from the office's cost allocation system.
- The office inappropriately awarded federal DCSI funds totaling \$1.2 million to four subrecipients whose projects had already received funding for the maximum period of time allowed by federal law.
- The office did not have sufficient cash management procedures in place to minimize the time between the drawdown of DCSI funds and the issuance of related warrants. For 49 (65 percent) of 75 claim schedules we reviewed, warrants were issued from 1 to 11 days late.

Improper Allocation of Payroll Costs

The office inappropriately charged the salaries of three employees to the DCSI grant. Two of these three employees transferred to units other than those directly related to the DCSI grant during fiscal year 1994-95: one on February 1, 1995, and the other on March 14, 1995. After their transfer, however, the office continued to charge a portion of their salaries to the DCSI grant through June 30, 1995. Although the office appropriately changed the employees' personnel records to reflect the change in assignments, it did not change the allocation of these two employees' payroll costs in its accounting system. As a result, the office inappropriately charged the DCSI grant \$23,141 during fiscal year 1994-95 for the two employees. The office also inappropriately charged the DCSI grant for a third employee who was on loan from February 1994 through July 1995 to a unit not directly related to the DCSI grant. For this employee, the office inappropriately charged the DCSI grant \$27,286 in salary costs during fiscal year 1994-95 and \$11,009 during fiscal year 1993-94.

Cost principles for determining allowable costs of programs administered by the State under grants received from the federal government state that a cost is allowable to a particular program only to the extent that the program receives benefit from such cost.

Improper Allocation of Indirect Costs

During fiscal year 1994-95, the office made two types of errors when allocating indirect costs to applicable programs and funds. First, the office did not properly allocate its facilities operations costs to all applicable programs. Facilities operations consist of six types of costs: rent on state- and nonstate-owned property, security, recurring maintenance, facilities planning, and facilities alterations. The office charged all costs associated with facilities operations to only one state program even though these costs benefited all programs, including federal ones. This error occurred because office staff incorrectly entered into the California State Accounting and Reporting System (CALSTARS) the cost allocation tables for indirect costs related to facilities operations. Further, we saw no evidence that the office reviewed the cost allocation tables after they were entered into CALSTARS. As a result of this error, the office did not charge any of its other state or federal programs for these costs even though other programs also benefited. For example, if the office had properly allocated office rent, one of the six types of facilities operations costs, to all applicable state and federal programs, it would have charged the DCSI grant \$38,442 rather than \$0 for rent during fiscal year 1994-95. This error affected other state and federal programs similarly.

Second, the office incorrectly allocated administration costs. Although it appears that the office properly entered into CALSTARS the cost allocation information for administration costs, the actual monthly cost allocations performed by CALSTARS excluded 1 of 39 cost centers. The office uses these cost centers to accumulate costs for all of its state and federal programs. The omitted cost center should have been charged 3.242 percent for administration costs; however, that 3.242 percent was erroneously allocated among other cost centers, including state and federal programs. The office could not identify why this error occurred. Because one cost center was excluded from the cost allocation, the other 38 cost centers incorrectly received a higher share of administration costs for the entire fiscal year. For example, the office overcharged the DCSI grant nearly \$27,000 during fiscal year 1994-95 for administration costs because of this error.

Cost principles for determining allowable costs state that indirect costs should be distributed to cost centers on the basis that will produce an equitable result in consideration of relative benefits received. Additionally, the CALSTARS Procedures Manual states that, before performing monthly cost allocations, employees should review the cost allocation tables for accuracy and completeness to avoid serious errors in the cost allocation and fund distribution process.

Noncompliance With Grant Limitations

The office inappropriately awarded DCSI funds to subrecipients whose projects had already received funds for the maximum period of time allowed by federal law. Specifically, we noted at least four instances in which the office awarded federal funds to subrecipients whose projects exceeded the allowable four-year time limit. During fiscal year 1994-95, these four subrecipients received \$1.2 million in DCSI funds. These errors occurred because office staff did not properly prepare project reports, which track the length of time projects receive funds, and supervisors did not adequately review the reports. The office believes that it did not inappropriately award funds to these four subrecipients. It stated that, in one instance, it will

be seeking approval of a retroactive waiver to the four-year time limit from the federal government. For two other instances, the office stated that it misclassified the type of project and should have classified them as a type that is exempt from the four-year time limit. As of the close of our fieldwork, however, the office had not reclassified these projects. Regarding the final instance, the office believes that it funded a new project with an existing subrecipient because the subrecipient changed the type of criminal targeted by the project. Our review of the office's documentation, however, showed that this change did not meet federal guidance. This guidance states that a new project is one which, while perhaps retaining some elements of an existing project, has fundamentally changed in the focus, scope, or approach from the original project. Failure to comply with the federal program requirements when awarding DCSI funds could jeopardize current or future funding under this grant.

Federal law states that, with certain exceptions, the office may not award funds to a grant recipient for a program or project that has already received grant funds for four years.

Inadequate Procedures Concerning Cash Management

For the DCSI grant, the number of days from the office's drawdown of federal funds to the issuance of related warrants by the State Controller's Office (SCO) was excessive. For 49 (65 percent) of the 75 claim schedules we reviewed, the SCO issued warrants more than 5 days after the office drew down the federal funds. The number of days beyond 5 ranged from 1 to 11. The number of days from drawdown of federal funds and issuance of warrants was excessive because the office did not inform the SCO when claim schedules it submitted were related to federal financial assistance programs covered by the Cash Management Improvement Act (CMIA). The SCO expedites claim schedules pertaining to federal financial assistance programs covered by the CMIA in order to reduce the potential amount of interest the State must pay on federal funds requested in advance of the issuance of warrants. Office staff informed us that the Department of Finance recommended, but did not require, state agencies to notify the SCO when claim schedules pertaining to federal financial assistance programs were covered by the CMIA. The office opted not to do so. The office believes that it would have incurred additional costs arising from a change in its procedures. However, because the office did not inform the SCO when claim schedules it submitted related to federal financial assistance programs covered by the CMIA, the State incurred unnecessary interest costs.

The Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments (Common Rule), which establishes requirements to state governments receiving federal grants, states that grantees must draw down funds as close as possible to the time of making disbursements. For the DCSI grant, we believe that five working days is a reasonable amount of time from the drawdown of federal funds to the issuance of related warrants.

Issue Reported in Prior Years

The following item is similar to one reported in previous years and, due to its significance, warrants corrective action by the office.

Audit Reports Not Submitted and Reviews of Audit Reports Not Conducted Within Required Deadlines

The office did not adequately monitor the submission and evaluation of audit reports from subrecipients of DCSI or SDFS grant funds. Specifically, within one year after the end of the audit period, the office had not received audit reports from 3 of the 18 subrecipients we reviewed. Because these subrecipients each received federal funds ranging from \$70,000 to \$77,180 during fiscal year 1994-95, they had an option of receiving either single audits for each of the fiscal years for which the grants were applicable or program-specific audits covering the entire grant periods. A single audit covers the entire operations of a subrecipient, while a program-specific audit covers only a specific federal program in which the subrecipient participates. If the subrecipients chose to receive single audits, they should have submitted the reports covering the first fiscal year (1993-94) by June 30, 1995. These single audits were 285 days late as of the end of our audit fieldwork on April 10, 1996. If the subrecipients chose to receive program-specific audits, reports were due six months after the end of the grant period. For each of the three subrecipients, applicable deadlines were February 28, 1995, June 30, 1995, and November 30, 1995. These program-specific audits were 407, 285, and 132 days late as of April 10, 1996. In response to these late reports, the office assigned its contracted auditor to conduct an audit of one of the three subrecipients and sent out late notices to the other two.

For three other subrecipients, the office did not ensure that reviews of audit reports were completed within six months of their receipt. These reviews ranged from 81 to 151 days late as of April 10, 1996. Although the office contracted with a private auditor to perform reviews of audit reports submitted by subrecipients, it did not provide the auditor with a deadline for completion of the reviews. As a result, the office could not ensure that the reviews were completed and could not take any necessary corrective action within six months. If the office fails to ensure that subrecipients submit required audit reports or fails to ensure timely corrective action, the federal government can withhold grant funds or deny subsequent grant awards.

The Office of Management and Budget (OMB), Circular A-128, requires state governments that receive federal financial assistance and provide \$25,000 or more of it to a subrecipient to ensure that appropriate corrective action is taken within six months after receipt of an audit report when instances of noncompliance with federal laws and regulations are identified.

Finally, the office's grantee handbook requires subrecipients to submit an audit report to the office no later than six months after the close of the grant period. It further states that failure to submit an audit report will result in special conditions being placed on the grant, such as the withholding of grant funds or the denial of subsequent grant awards.

Other Instances of Noncompliance With Federal Requirements

In the following instances the office did not comply with certain federal requirements.

Inadequate Monitoring of Grant Applicants' Equal Employment Opportunity Programs

The office did not receive a written description of the equal employment opportunity (EEO) programs from the four subrecipients of SDFS funds that we reviewed. These four subrecipients received from \$48,353 to \$100,000 in federal financial assistance during fiscal year 1994-95. The office's EEO branch did not monitor the receipt of the EEO programs for these subrecipients because the office's fiscal division did not notify the EEO branch of the existence of these grants. As a result, the office lacks assurance that subrecipients of SDFS grants are in compliance with federal EEO requirements.

Federal regulations require each recipient of federal grants or subgrants of \$25,000 or more to formulate, implement, and maintain a written EEO program. Further, the office's grantee handbook requires subrecipients of federal financial assistance from \$25,000 to \$499,999 to prepare and submit an EEO program.

Inadequate Procedures for Tracking Federal Funds

The office could not provide documentation concerning how long some of the federal funds it received had been on hand. Specifically, for \$661,000 (18 percent) of \$3.7 million associated with five claim schedules that we reviewed, the office could not provide supporting documentation showing when it received these federal funds or how long these funds had been on hand. The office could not provide such documentation because its existing procedures are not designed to track the length of time all federal funds have been on hand.

Federal regulations require a state to maintain records supporting interest calculations, clearance patterns, direct costs, and other functions directly pertinent to the implementation and administration of regulations adopted in response to the CMIA. Further, the Common Rule states that the State's fiscal control and accounting procedures must be sufficient to permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.

Unsupported Costs on Federal Financial Reports

The office reported, in its fiscal year 1994-95 federal financial status reports for the DCSI grant, \$54,705 in support costs in excess of those recorded in its own expenditure reports. Staff of the office could not explain the difference in costs incurred during the fiscal year. The costs reported on the financial status reports should agree with the office's expenditure reports because they are both compiled using the same data and accounting system.

Federal grant guidelines require that financial reports contain accurate and reliable information and that grantees maintain accounting records that adequately identify the source and application of funds.

***Incomplete and Inaccurate Reports
Submitted to the Department
of Alcohol and Drug Programs***

During fiscal year 1994-95, the office was awarded \$2,543,000 in SDFS funds from the Department of Alcohol and Drug Programs (DADP). However, the office did not provide to the DADP complete and accurate progress reports related to the SDFS grant as required. Specifically, we noted the following errors:

- In its six-month report, the office omitted 1 of 4 reporting requirements for three programs and 1 of 10 requirements for another program. The office believes that it did not need to include the omitted information in the six-month report for fiscal year 1994-95 because the information had not changed from when it was provided to the DADP during fiscal year 1992-93;
- For one program, the office overreported on the six-month report the number of people served by 1,613 (70 percent) and it underreported by 598 (15 percent) on the final report; and
- The office did not receive from two of six subrecipients required information on the race, ethnicity, gender, and age group of individuals served, nor did it submit this information to the DADP.

We also observed that information provided to the office by subrecipients and forwarded to the DADP was inconsistent and possibly inaccurate. Specifically, we noted seven instances in which the number and percentage of high-risk youths served as reported by the subrecipients were inconsistent with supporting information the subrecipients provided. For example, one subrecipient reported it served 1,591 high-risk youths. However, our calculation based on the supporting detail indicated that the number was 1,230. Another subrecipient reported 325 high-risk youths served, while we calculated only 161.

The errors in the office's reports it provided to the DADP occurred because office staff did not review information submitted to them to identify errors or inconsistencies. Because the office submitted inaccurate and incomplete information in its progress reports to the DADP, the DADP could not ensure that subrecipients of SDFS funds have achieved their performance goals.

Federal law requires that each state monitor subrecipients of SDFS funds to ensure that performance goals are being met.

Additionally, the interagency agreement between the office and the DADP requires the office to submit to the DADP a six-month report and, at the end of each fiscal year, a final progress report. The agreement requires the office to include a description of activities related to each program, the number of individuals served for all programs, and information concerning the number of high-risk youths served.

Subrecipients Did Not Meet Certain Program Requirements

Although the office received information from three subrecipients participating in the SDFS program that reported serving less than the required 90 percent of high-risk youths, the office took no actions to increase the percentage of high-risk youths served nor did it take steps to cease providing funds to these subrecipients. The office provided \$155,000 for these three subrecipients during fiscal year 1994-95. Specifically, one subrecipient's six-month progress report stated that the subrecipient had served 10 percent of high-risk youths, and in its final progress report, listed 6 percent. In its six-month report, another subrecipient claimed it had served 82 percent of high-risk youths, and in its final report, a third subrecipient reported serving 69 percent of high-risk youths. The office took no action in these instances because staff did not review the information submitted to them by the subrecipients. By not ensuring that all subrecipients were complying with federal program requirements, the office jeopardized its federal funding.

Federal law requires that at least 90 percent of participants in innovative programs funded by SDFS grants must be individuals who are high-risk youths.

Recommendations

To improve its control and accountability over cost allocations, the office should take the following steps:

- Ensure that employment changes are properly reflected in the accounting system's labor distribution tables for accurate payroll cost allocation;
- Ensure that it enters into CALSTARS the cost allocation tables in accordance with the cost allocation plan; and
- Have an employee other than the one entering the information verify that the data was properly entered.

To ensure that it does not provide federal funds to subrecipients whose projects have already received such funds for the maximum time allowed by law, the office should take the following actions:

- Correctly complete the project reports for each subrecipient before issuing grant awards; and
- Have supervisors review the project reports for accuracy.

To improve its cash management procedures, the office should do the following:

- Inform the SCO when it submits claim schedules related to federal financial assistance programs covered by the CMIA so that the SCO can expedite its processing of such claims; and
- Develop a system through which it can track the length of time all federal funds have been available.

To ensure its compliance with federal audit requirements, the office should take the following steps:

- Promptly address subrecipients who have not submitted required reports; and
- Provide the private contractor with an explicit deadline for completing its reviews of audit reports.

To ensure that it complies with federal reporting requirements, the office should do the following:

- Reconcile, at least quarterly, the amount reported on the financial status reports with its DCSI grant expenditure reports to ensure that all reported expenditures are supported;
- Modify its procedures to ensure that the fiscal division notifies the EEO branch when subrecipients receive SDFS funds so that the EEO branch can take steps to obtain written EEO programs from subrecipients;
- Review for accuracy and completeness the program participants' information submitted to the office by the subrecipients; and
- Before submitting them to the DADP, review the reports it prepares for accuracy and completeness.

Appendix

U.S. Department of Justice and U.S. Department of Education Grants

<u>Federal Catalog Number</u>	<u>Program Title</u>
16.579	Drug Control and System Improvement—Formula Grant
84.186	Safe and Drug-Free Schools—State Grants

Federal and State Criteria

Allocation of Payroll Costs and Cost Principles

OMB Circular A-87, Paragraph E(2)(a), states that direct costs chargeable to grant programs include compensation of employees for the time and efforts devoted specifically to the execution of grant programs. Additionally, Paragraph C(2)(a) states that a cost is allowable to a particular cost objective to the extent of benefits received by such objective.

The Program Cost Accounting chapter of the CALSTARS Procedures Manual states that, before performing a monthly cost allocation, employees should review the cost allocation tables for accuracy and completeness to avoid serious errors in the cost allocation and fund distribution process.

Time Limits for Funding

The United States Code, Title 42, Section 3754(f), requires that, under the Drug Control and System Improvement—Formula Grant, no funds be awarded to a grant recipient for a program or project for which funds have been awarded for four years. Exceptions to this limitation are those grants awarded to state and local governments for the purpose of participating in multi-jurisdictional drug task forces, victims assistance programs, or multi-jurisdictional gang task forces.

Eligibility

The United States Code, Title 20, Section 3192(b)(3), requires that at least 90 percent of the participants in innovative programs under the Safe and Drug-Free Schools—State Grants be individuals who are high-risk youths.

Cash Management Requirements

The Code of Federal Regulations, Title 31, Section 205.17(c), requires a state to maintain records supporting interest calculations, clearance patterns, direct costs, and other functions directly pertinent to the implementation and administration of federal regulations related to programs affected by the CMIA.

Section 20(b) of the Common Rule states that grantees must make drawdowns as close as possible to the time of making disbursements. For the DCSI grant, we believe that five working days is a reasonable amount of time from the drawdown of federal funds to the issuance of related warrants.

Section 20(a) of the Common Rule states that fiscal control and accounting procedures of the state must be sufficient to permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.

Audit Reports

OMB Circular A-128, Section 4.b., states that the Single Audit Act of 1984 requires local governments that receive between \$25,000 and \$100,000 a year in federal financial assistance be audited in accordance with OMB Circular A-128, or in accordance with federal laws and regulations governing the programs in which they participate. Section 13.f. states that the A-128 audits are due within one year after the end of the audit period.

OMB Circular A-128, Section 9.c., requires state governments that receive federal financial assistance and that provide \$25,000 or more of those funds to a subrecipient ensure that appropriate corrective action is taken within six months after receiving an audit of a subrecipient that identifies instances of noncompliance with federal laws and regulations.

Section 8120 of the office's grantee handbook requires subrecipients to submit an audit report (either single audit or program audit) to the office no later than six months after the close of the grant period. Section 8230 further states that failure to submit an audit report will result in special conditions being placed on the grant to comply with audit requirements, such as the withholding of grant funds, or denial of subsequent grant awards.

Equal Employment Opportunity Requirements

The Code of Federal Regulations, Title 28, Section 42.302(d), requires each recipient of federal grants or subgrants of \$25,000 or more to formulate, implement, and maintain an EEO program. Further, Section 42.304 requires that the recipient's EEO program must be in writing.

Section 2151, Part b., of the office's grantee handbook requires subrecipients of federal financial assistance between \$25,000 and \$499,999 to prepare and submit an EEO program.

Reporting Requirements

OMB Circular A-102, revised, Subpart C, Paragraph 883, Section .20(b), requires that financial reports contain accurate and reliable information and that grantees maintain accounting records that adequately identify the source and application of funds.

The Code of Federal Regulations, Title 34, Section 80.40(a), requires the State to monitor subrecipients of SDFS funds to ensure that performance goals are met.

The interagency agreement between the office and the DADP requires the office to submit a six-month progress report and a final progress report to the DADP. The agreement requires the office to include a description of activities related to each program, to report the number of individuals served for all programs, and to provide information concerning the percentage of high-risk youths served.

Department of Finance

We assessed the compliance of the Department of Finance (DOF) with federal and state regulations in administering the Statewide Cost Allocation Plan (SWCAP) and with state regulations in administering the Prorata Allocation Plan (Prorata).

Summary

We assessed the compliance of the DOF and a sample of other state departments with federal and state regulations in administering the SWCAP and with state regulations in administering the Prorata. We noted the following during our review:

- The department is not monitoring the transfers of state departments' SWCAP recoveries from the Federal Trust Fund to the State's General Fund to ensure that these transfers are accomplished each quarter, as required. For SWCAP reimbursements at 19 departments, we found that 10 departments did not transfer SWCAP reimbursements from the Federal Trust Fund to the State's General Fund at all during fiscal year 1994-95. Another 5 departments were late in transferring their SWCAP recoveries.
- The department has not detected or prevented an error in its cost allocation plan. In compiling total SWCAP expenditures for fiscal year 1994-95, the DOF neglected to include about \$33 million of expenditures.

Background

Twelve executive agencies reporting to the governor and the Department of Justice, the Legislature, the Bureau of State Audits, the State Controller's Office, the State Library, and the State Treasurer's Office, provide various services to all state agencies. These entities are called "central service agencies," and provide such services as financial, personnel, and legal support. (Attachment A lists the agencies performing central services during fiscal year 1994-95 and identifies the four agencies we reviewed.) The federal government's share of central service agency costs is recovered through the SWCAP while the special funds share of these costs are recovered through the Prorata. (Attachment B shows the estimated SWCAP and Prorata expenditures and recoveries for fiscal year 1994-95.)

The SWCAP is a statewide cost allocation plan that outlines how each state agency administering federal programs is to obtain reimbursement for the federal government's share, if any, of the State's costs for providing central services. The Prorata is the cost allocation plan outlining how each state agency is to obtain reimbursement from special funds for those funds' share, if any, of the costs for central services. The State's General Fund is reimbursed for these costs because it initially provides the funds to pay for the central services.

***Statewide Cost Allocation Plan
Reimbursements Not
Transferred Promptly***

In our review of SWCAP reimbursements at 19 departments, we found that 10 departments did not transfer SWCAP reimbursements from the Federal Trust Fund to the State's General Fund at all during fiscal year 1994-95. Another 5 departments were late in transferring their SWCAP recoveries. The State Administrative Manual requires departments to transfer SWCAP recoveries within 30 days of the end of each quarter.

Specifically, ten departments did not transfer SWCAP reimbursements during the fiscal year 1994-95 even though they were required to do this quarterly. Some of these departments told us that they were not aware of the requirement to transfer SWCAP recoveries. Other departments cited the lack of trained staff, or the lack of an approved indirect cost plan, as the reasons for not transferring SWCAP reimbursements to the General Fund. Of the five departments that were late in making the transfers, three departments did not promptly request the State Controller's Office (SCO) to transfer reimbursements within the period specified by the state regulations. A state department receiving SWCAP reimbursements must request the SCO to transfer this amount to the State's General Fund. Before it can be submitted to the SCO, the transfer request must be approved by a DOF budget analyst. The other two departments submitted their transfer requests on time, but the DOF budget analysts did not approve the transfer requests promptly. The analyst responsible for approving the transfer requests for the first and second quarter of the fiscal year took over four months to process them.

The following lists the 15 departments that transferred SWCAP reimbursements more than 30 days after the end of a quarter.

Department	Estimated SWCAP Amount for 1994-95	Fiscal Year 1994-95 Quarter of Transfer	Number of Days Late
Office of Emergency Services	\$ 197,000	None	*
Department of Forestry & Fire Prevention	80,000	None	*
Department of Economic Opportunity	162,000	None	*
Department of Transportation	43,000	None	*
Department of Motor Vehicles	4,000	None	*
California Conservation Corps	70,000	None	*
Board of Governors	17,000	None	*
Department of Parks and Recreation	37,000	None	*
California Occupational Information Coordinating Committee	10,000	None	*
Public Utilities Commission	3,000	None	*
Department of Industrial Relations	442,000	First	123
		Second	144
		Third	54
Department of Toxic Substances Control	533,000	First	212
		Second	120
		Third	51
Office of Criminal Justice Planning	63,000	First	232
		Second	140
		Third	50
Department of Alcohol and Drug Programs	417,000	First	191
		Second	99
		Third	9
Department of Justice	335,000	First	235
		Second	143
		Third	53
Estimated Late SWCAP Payments	\$ 2,413,000		

* Ten departments did not transfer any SWCAP recoveries for fiscal year 1994-95.

Issue Reported in Prior Years

The following issue was reported in previous years and due to its significance warrants corrective action by the department.

Inaccurate Expenditure Data Used in the SWCAP and Prorata Allocations

Each fiscal year, as part of the development of the SWCAP and Prorata allocation plans, the DOF first compiles the total expenditures for each central service agency. Since it is the total of these expenditures that is allocated to state agencies, the department needs this information before it can formulate an allocation plan. However, the department erred in compiling total central service expenditures for fiscal year 1994-95 because it neglected to include about \$33 million of expenditures for retired employees' dental benefits. The cost of dental benefits for retired employees is a component of a major central service expenditure, Health

Benefits for Retired Annuitants (HBRA). Not including \$33 million in expenditures in the cost allocation plans can result in the undercollection of SWCAP recoveries from the federal government and also undercollection of Prorata expenditures from the State's special funds.

After we notified the DOF of its error, it asked the U.S. Department of Health and Human Services (DHHS) whether a revised cost allocation plan was required to include the missing \$33 million of expenditures. The DHHS, which approves the State's cost allocation plan, directed the DOF not to submit a revised plan for fiscal year 1994-95, stating that there was no need to adjust for this error. The DHHS contends that the State had previously overcollected SWCAP recoveries because the amounts that the California Public Employees' Retirement System had estimated for prior years' HBRA benefits had been overestimated by at least \$33 million. For this reason, the error we discovered has not resulted in an adjustment.

State law requires departments to maintain an effective system of internal control to check the accuracy and reliability of accounting data, including an effective system of internal review. However, in this instance, the department's procedure failed to detect that the \$33 million was omitted from its cost allocation plan.

Recommendations

To ensure that departments comply with the state regulations, the department should monitor state departments to ensure that they transfer SWCAP recoveries to the State's General Fund timely.

To improve its system of internal controls over its Statewide Cost Allocation Plan and Prorata calculations, the department should develop and implement control procedures to detect and prevent errors in compiling its cost allocation plan.

Appendix

Criteria

Transfers of SWCAP Recoveries

The California Government Code, Section 13332.01, requires departments to recover SWCAP costs from the federal government. Section 13332.02 of the Code requires departments to transfer all funds recovered from the federal government to the State's General Fund in a manner prescribed by the DOF. The Government Code also states that if a state department has not transferred the funds on a timely basis, the DOF may request the State Controller's Office to transfer the amount which the department should have transferred to the General Fund. The State Administrative Manual, Section 8755.2, stipulates that a transfer of SWCAP recoveries to the State's General Fund be accomplished within 30 days of the end of the quarter.

Internal Control

The California Government Code, Sections 13402 and 13403, requires agencies to have a satisfactory system of internal accounting and administrative controls to check the accuracy and reliability of accounting data, including an effective system of internal review.

Attachment A

**Agencies Performing Central Services
Fiscal Year 1994-95**

Agency Name	Reviewed by the Bureau of State Audits
Department of Finance	X
Department of Justice	
Department of Personnel Administration	
Health Benefits for Retired Annuitants (administered by the Public Employees' Retirement System)	X
Legislature	
Office of Administrative Law	
Bureau of State Audits	
Business, Transportation and Housing Agency	
Health and Welfare Agency	
Resources Agency	
State and Consumer Services	
Youth and Adult Correctional Agency	
State Board of Control	
State Controller's Office	X
State Library	X
State Personnel Board	
State Treasurer's Office	
Environmental Protection Agency	

Attachment B

***Estimated SWCAP and Prorata
Expenditures and Recoveries
Fiscal Year 1994-95
(In Millions)***

Estimated SWCAP expenditures	\$379.5
Estimated SWCAP recoveries from the federal government	35.5
Percent of estimated recoveries	9.4%

Estimated prorata expenditures	\$449.6
Estimated prorata recoveries from the State's special funds	163.8
Percent of estimated recoveries	36.4%

Source: State of California, Department of Finance

Health and Welfare

Department of Aging

We reviewed the Department of Aging's (department) administration of the U.S. Department of Health and Human Services grants, Federal Catalog Nos. 93.044 and 93.045.

An Issue Reported in Prior Years

We reported the following item in the previous two years. This issue has not been fully corrected and, because of its significance, warrants corrective action by the department.

The Department Did Not Meet All Its Monitoring Responsibilities

The department did not fulfill all of the monitoring responsibilities for the Area Agencies on Aging that the federal government requires under the Special Programs for the Aging grant for supportive and nutrition services. When we reported a similar finding last year, the department asked the federal Department of Health and Human Services (DHHS) to delineate the monitoring requirements. The DHHS responded that financial audits, four different kinds of desk reviews, and biennial on-site reviews of the area agencies constitute adequate monitoring. Although the department met the requirements for the desk audits and performed some financial audits, it did not perform all the required biennial on-site reviews. During fiscal years 1993-94 and 1994-95, the department's community services and nutrition units, which are responsible for on-site reviews, visited 30 of the 33 area agencies, failing to conduct on-site reviews at the remaining 3. In addition, 12 of the 30 on-site reviews were for nutrition services only and did not include assessments for supportive services. Failure to conduct thorough evaluations may prevent early detection and correction of deficiencies in the services provided by the area agencies.

Recommendation

The department should ensure that on-site reviews of nutrition and supportive services for the Special Programs for the Aging are conducted of all area agencies at least every two years.

Appendix

U.S. Department of Health and Human Services

<u>Federal Catalog Number</u>	<u>Program Title</u>
93.044	Special Programs for the Aging, Title III, Part B, Grants for Supportive Services and Senior Centers
93.045	Special Programs for the Aging, Title III, Part C, Nutrition Services

Federal and State Criteria

Monitoring Requirements

The United States Code Annotated, Title 42, Section 3027(a)(8), requires the department to conduct periodic evaluations of activities and projects carried out under Title III of the Older Americans Act.

Although the Code of Federal Regulations, Title 45, Section 1321.3 defines periodic as, at a minimum, once each fiscal year, the federal DHHS agreed, in a letter dated July 6, 1995, that biennial on-site evaluations were adequate for monitoring the supportive and nutrition services funded by the Special Programs for the Aging grant.

Department of Alcohol and Drug Programs

We reviewed the Department of Alcohol and Drug Programs' (department) administration of the U.S. Department of Education grant, Federal Catalog No. 84.186, and the U.S. Department of Health and Human Services grants, Federal Catalog Nos. 93.778 and 93.959.

Summary

We reviewed the department's administration of the U.S. Department of Health and Human Services grants and the U.S. Department of Education grants. We noted the following concerns during our review:

- The department did not maintain the required level of state funding for the Substance Abuse Prevention and Treatment (SAPT) block grant.
- The department did not meet the requirements for the SAPT block grant to provide services to pregnant women and women with dependent children.
- The department exceeded the 2.5 percent limit on administrative expenditures for the Safe and Drug-Free Schools (SDFS) grant for the last two fiscal years.
- The department did not adequately monitor subrecipients for the SDFS grant. For example, it did not consistently perform quarterly site reviews or require subrecipients to submit quarterly and final reports on time. In addition, quarterly reports that subrecipients submitted did not contain all the information required by the interagency agreements or contracts.

The Department Did Not Ensure Timely Resolution of Audit Findings

The department did not ensure prompt resolution of findings from the audits of subrecipients of the SAPT and SDFS grants for fiscal year 1993-94. Subrecipients that receive at least \$25,000 in federal funds in a year are required to have an audit performed of their operations. The federal Office of Management and Budget (OMB), Circular A-128, requires the department to also ensure that subrecipients take corrective action on audit findings within six months of the department's receipt of the audit reports. The department did not adequately follow up on any of the audit findings in the four reports with findings that we reviewed. The findings related to inadequate written policies, inadequate monitoring of contractors, and late and erroneous cost reports. Without adequate follow-up on these audit findings, the department cannot ensure that subrecipients' administration of federal programs complies with federal requirements.

The Department Did Not Submit Quarterly Reports on Drug Medi-Cal Utilization Reviews

The department did not submit quarterly utilization review reports on the Medical Assistance Program (Drug Medi-Cal) to the Department of Health Services (DHS). The Code of Federal Regulations and the interagency agreement with DHS require the department to perform

reviews to ensure subrecipients are in compliance with Drug Medi-Cal utilization requirements and to submit quarterly reports to DHS. Although the department performed the utilization reviews during fiscal year 1994-95, it failed to submit the quarterly reports to DHS. DHS uses these reports to evaluate the department's system for monitoring the subrecipients' utilization of Drug Medi-Cal services. Without these reports, DHS cannot be assured that program services are being used appropriately.

Issues Reported in Prior Years

The following items were reported in previous years, have not been corrected, and due to their significance warrant corrective action by the department.

The Department Did Not Maintain State Funding for SAPT Block Grant Purposes

The department did not maintain the levels of state funding required for the SAPT block grant. Specifically, during the 1994-95 fiscal year, the department expended \$557,000 less on all grant-related activities than the average expenditures for the two prior years. The United States Code requires the department to maintain total state expenditures at a level at least equal to the average annual expenditures for the preceding two-year period. In addition, during fiscal year 1994-95, the department expended \$509,000 less on funding for services to pregnant women and women with dependent children than it did in fiscal year 1993-94. The United States Code requires that the department maintain the level of these expenditures at least equal to the prior fiscal year's expenditures. By not maintaining the required level of expenditures, the department increases the risk of losing federal funds.

Administrative Costs Charged to the SDFS Grant Exceeded Allowable Costs

The department spent approximately \$721,000 in federal funds to administer the SDFS grant in fiscal year 1994-95, almost double the allowable amount of \$360,000. Although it limited its budgeted administrative costs for the grant to the 2.5 percent allowed by the United States Code, the department did not compare budgeted to actual administrative expenditures during the year so that it could limit the charges to the grant to the budgeted amounts. Failure to comply with the federal requirement to limit state administrative costs to 2.5 percent of the grant amount could result in the reduction of future federal grant monies.

The Department Did Not Adequately Monitor Interagency Agreements and Contracts

The department did not adequately perform all monitoring procedures for subrecipients of the SDFS grant. Procedures require the department to monitor, through both site visits and desk reviews, information provided by subrecipients. However, during fiscal year 1994-95, the department failed to conduct these monitoring procedures, and the following problems occurred:

- The department entered into an interagency agreement, funded with SDFS grant money, with the Office of Criminal Justice Planning (OCJP). The agreement required OCJP to submit a six-month progress report and a year-end final report that contained specific information related to activities funded by the grant. However, OCJP reported

inaccurate information and failed to include in its reports a required description of the activities related to programs funded by the SDFS grant. The department did not follow up on these deficiencies. The department also did not adequately monitor the reports to ensure that at least 90 percent of the individuals served were high-risk youth, as required by the interagency agreement.

Further, the interagency agreement allowed OCJP to award a portion of the grant funds to local service providers, who are considered OCJP subrecipients. However, during fiscal year 1994-95, the department did not comply with the requirement of the interagency agreement to conduct meetings with OCJP to review progress, formulate plans, evaluate programs, and discuss any difficulties or problems. In addition, the department did not enforce the terms of the interagency agreement requiring OCJP and the department to perform quarterly site visits with selected subrecipients.

- The department entered into contracts with school districts to provide services for alcohol and drug abuse. The contracts required that these subrecipients submit quarterly and final reports within 30 days of each period's end. One of the six school districts we reviewed failed to submit any reports during fiscal year 1994-95, and the department did not follow up on the missing reports. The contracts also required that the department conduct quarterly and year-end final meetings or conferences with the districts. The department failed to conduct quarterly meetings for two of the six school districts we reviewed and final meetings for five of the six.

The Code of Federal Regulations requires the department to manage the day-to-day operations of the activities supported by the grant and subgrant. Because it does not follow its procedures for monitoring interagency agreements and contracts, the department cannot ensure that subrecipients of the SDFS grant achieve their performance goals, accurately report program results, or comply with applicable federal requirements.

The Department Did Not Adequately Monitor the Cash Balances of Subrecipients

The department did not adequately monitor the quarterly cash transaction reports for the SAPT block grant and the SDFS grant. The department awards funds to counties to provide prevention and treatment services for alcohol and drug abuse and requires the counties to submit quarterly cash reports indicating the amount of funds spent for specific grants and programs. However, during fiscal year 1994-95, the department did not receive any quarterly cash transaction reports from 3 of the 14 counties we reviewed. We found no evidence that the department made any attempts to obtain these reports from the counties. Ten of the twelve quarterly reports we reviewed from other counties were late by up to 38 days.

In addition, the department did not promptly reconcile the counties' quarterly cash transaction reports to its own records. Specifically, although 2 of the 12 county reports we reviewed reported cash receipts that did not agree with the department's records, the department did not reconcile the differences until we brought the issue to its attention. It uses the quarterly cash transaction reports to monitor the cash needs of the counties and to adjust cash advances to counties based on the amount of cash on hand. Two of the twelve reports indicated the counties had over 30 days of cash on hand, but the department did not adjust subsequent advance payments to these subrecipients. The department cannot ensure that it limits monthly cash advances to the immediate needs of the subrecipients, as required by the Code of Federal Regulations, without adequate procedures to monitor their cash balances.

The Department Has Not Contracted for Independent Peer Reviews

The department has not contracted for independent peer reviews of the alcohol and drug treatment providers receiving funds from the SAPT block grant. The Code of Federal Regulations required that the independent peer reviews begin in fiscal year 1993-94, with at least 5 percent of providers reviewed annually. Although it solicited and received bids to perform the independent peer review, as of March 1996, the department was unable to find a suitable contractor to perform the reviews. Without these reviews, the department cannot ensure the alcohol and drug treatment providers receiving funds from the SAPT block grant are meeting performance goals or providing services consistent with the objective of the block grant.

Recommendations

Levels of Funding

To ensure that it complies with the requirements for maintaining the level of state funding for the SAPT block grant as a whole, the department should implement procedures to ensure that state expenditures are at least equal to the average annual expenditures for the preceding two-year period for similar activities.

To ensure that it complies with the requirements of the Code of Federal Regulations for the SAPT block grant for the level of funding related to services for pregnant women and women with dependent children, the department should periodically review its expenditures for these services. The department should implement procedures to monitor and ensure compliance with all applicable federal, state, and department requirements.

To ensure that it complies with requirements for the SDFS grant, the department should periodically compare actual to budgeted administrative costs and establish procedures to ensure that the administrative costs charged to the federal grant do not exceed the limitation imposed by the federal government.

Monitoring Issues

To ensure that it complies with the requirements of OMB Circular A-128, the department should develop procedures to resolve audit findings within six months, as required.

To ensure that DHS can review the effectiveness of its utilization reviews of Drug Medi-Cal subrecipients, the department should submit quarterly utilization review reports.

To ensure that subrecipients comply with requirements for the SDFS grant, the department should establish procedures for conducting quarterly site visits and review reports to determine whether the subrecipients are documenting their compliance with federal requirements and performance goals.

To ensure that subrecipients comply with the requirements for its SAPT block grant program, the department should immediately take steps to organize independent peer reviews. At least 15 percent of the entities that provide alcohol and drug treatment services should be covered by these reviews, which would bring the department up to date with the requirement that at least 5 percent of the entities be reviewed each fiscal year starting in fiscal year 1993-94.

Cash Management

To improve its control and accountability over funds for the SAPT block grant and SDFS grant, the department should ensure that its subrecipients submit their quarterly cash transaction reports by the required due dates. The department should also maintain proper control and accountability of its grant cash and ensure that funds are advanced to the subrecipients for actual and immediate cash needs only.

Appendix

U.S. Department of Education and U.S. Department of Health and Human Services Grants

<u>Federal Catalog Number</u>	<u>Program Title</u>
84.186	Safe and Drug-Free Schools—State Grants
93.778	Medical Assistance Program
93.959	Block Grant for the Prevention and Treatment of Substance Abuse

Federal and State Criteria

Internal Controls

The California Government Code, Sections 13401 and 13403, requires agencies to maintain an effective system of internal controls that includes effective accounting controls over assets, liabilities, revenues, and expenditures.

The State Administrative Manual, Section 8080.1, requires agencies to establish and maintain an adequate system of internal controls.

Levels of Funding

The United States Code, Title 42, Section 300x-22(c)(1)(c), which relates to the Block Grant for the Prevention and Treatment of Substance Abuse, requires that the State expend not less than an amount equal to the amount expended by the State for the previous fiscal year for services for pregnant women and women with dependent children.

The United States Code, Title 42, Section 300x-30(a), requires the State to maintain expenditures for authorized activities at a level equal to or greater than the average expenditures maintained by the State for the two-year period preceding the fiscal year of the block grant award.

The United States Code, Title 20, Section 3191(a)(2), limits state-level expenditures for administrative costs of the Safe and Drug-Free Schools (SDFS) grant to 2.5 percent of the total grant amount paid to the State. Further, the Code of Federal Regulations, Title 34, Section 74.61(d), requires the State to compare the actual and budgeted administrative costs for each grant.

Monitoring Issues

The federal Office of Management and Budget, Circular A-128, Section 14, states that the entity providing funds to the subrecipient is responsible for ensuring the resolution of audit findings pertaining to grants within six months after receipt of the report.

The Code of Federal Regulations, Title 42, Section 456, Subpart A, requires the State to provide methods and procedures to safeguard against unnecessary utilization of Drug Medi-Cal care and services.

The Code of Federal Regulations, Title 34, Subtitle A, Part 80, Section 80.40, which is related to the SDFS grant, states that grantees are responsible for managing operations of the grant and subgrant activities. Grantees must monitor supported activities to ensure compliance with applicable federal requirements and ensure that performance goals are achieved. Grantee monitoring must cover each program, function, or activity.

The United States Code, Title 42, Section 300x-53(a)(1), and the Code of Federal Regulations, Title 45, Section 96.136, require the department to provide periodic independent peer reviews to assess the quality, appropriateness, and efficacy of treatment services provided by entities receiving funds from the Block Grants for the Prevention and Treatment of Substance Abuse. In addition, the United States Code requires that, in the conduct of these peer reviews, not fewer than 5 percent of the entities providing services in the State be reviewed.

Cash Management

The Code of Federal Regulations, Title 31, Section 205.7(d), requires that cash advances to a primary recipient be limited to the minimum amounts required to meet the actual immediate cash needs of the recipient. The timing and amount of cash advances must be as close as administratively feasible to the actual disbursements by the recipient for program costs.

Department of Developmental Services

We reviewed the financial operations and related internal controls of the Department of Developmental Services (department) and the department's administration of the U.S. Department of Education grant, Federal Catalog No. 84.181.

Summary

We reviewed the department's administration of the U.S. Department of Education Special Education—Grants for Infants and Families With Disabilities (Early Start) program. We noted the following concerns during our review:

- The department did not comply with the federal Drug-Free Workplace Act of 1988 because the department had not developed or distributed a Drug-Free Workplace policy.
- Although the department has a monitoring process over its Early Start program, the department does not maintain complete documentation of its reviews.
- The department allocated indirect costs to the Early Start program without preparing an indirect cost rate proposal (ICRP) and obtaining approval from the federal government.
- The department maintained balances of federal funds that exceeded their immediate cash needs.

The Department Has Not Complied With the Federal Drug-Free Workplace Requirements

During our audit covering fiscal year 1994-95, we found that the department had not complied with the federal Drug-Free Workplace Act (Act) of 1988, because the department had not developed its own Drug-Free Workplace policy or implemented the State's policy as developed by the Department of Personnel Administration. In April 1996, the department finalized and adopted its first Drug-Free Workplace policy. However, we still have concerns about the department's new policy because it does not contain all the provisions required by the Act, such as a statement that it is unlawful to manufacture, distribute, dispense, possess, or use a controlled substance in the grantee's workplace. The statement also does not inform employees that, as a condition of employment, they must abide by the statement. Further, the department has not yet distributed or informed its employees about the new policy. Without the full implementation of its policy, the agency cannot ensure that it is meeting the goals of the Act.

Federal law requires the department to have an ongoing drug-free workplace program. Additionally, state administrative policy requires departments to distribute the State's policies for achieving a drug-free workplace to all affected employees.

Insufficient Monitoring of the Early Start Program

Although the department has a monitoring process over its federal Early Start program, the department does not maintain complete documentation of their reviews. Specifically, the department did not maintain documentation of its fiscal reviews over regional centers' services provided in fiscal year 1994-95. In addition, the department did not always complete its monitoring instrument to verify the regional center's compliance with specific federal requirements such as completion of the required Individual Family Service Plan. Furthermore, the department does not have written procedures that require department staff to maintain documentation of their monitoring reviews.

Federal regulations require states to monitor subrecipient activities to ensure they comply with federal requirements applicable to the Early Start program. Without adequate documentation to provide evidence of its monitoring activities, the department may not be able to assess achievement of federal objectives and proper use of funds.

Other Instances of Noncompliance With Federal and State Requirements

In the following instances, the department did not comply with certain federal or state requirements.

Indirect Costs Charged to the Federal Government Without Approval

During fiscal year 1994-95, the department allocated indirect costs to the Early Start program without preparing an ICRP. Although the department's method for allocating indirect costs to the Early Start program appears reasonable, the department has not prepared an ICRP and has not submitted the proposal to the federal government for approval. As a result, the federal government could disallow the department's indirect costs allocated to the Early Start program.

Both federal and state regulations require departments that receive federal funds to prepare an ICRP in accordance with federal regulations.

Cash Management Procedures

During fiscal year 1994-95, the department maintained balances of federal funds that exceeded their immediate cash needs. These balances occurred because the department does not always minimize the time between receipt and disbursement of federal funds. Specifically, the department was 6 to 147 days late in disbursing funds that resulted in cash on hand balances of between approximately \$3,600 and \$1.9 million. We consider a disbursement late if it is delayed more than 5 days after the receipt of federal funds.

Federal law requires that cash advances to a state be limited to the minimum amounts needed and timed to be in accordance with actual immediate cash requirements of the state. In addition, the law requires that the timing and amount of cash advances be as close as administratively feasible to the actual cash outlay by the state.

Recommendations

To ensure that it complies with general requirements for its Early Start program, the department should:

- Incorporate into its new policy on federal Drug-Free Workplace requirements all the required elements; and
- Inform its employees of the federal requirements related to a drug-free workplace and distribute the department's policy to its employees.

To improve its control and accountability over funds for its Early Start program, the department should:

- Maintain complete documentation of its monitoring efforts over regional centers;
- Establish a formal policy that monitoring staff can follow that describes the type of documentation which should be maintained to support their monitoring efforts;
- Confer with the U.S. Department of Education to determine what action is necessary to obtain federal approval of its indirect cost allocation system;
- Develop and submit its annual ICRP for fiscal year 1994-95 to the federal government or get exemption status;
- Maintain proper control and accountability of its grant cash and ensure that any cash on hand is considered prior to making disbursements and requesting drawdowns of federal funds;
- Minimize the time elapsed between receipt of federal funds and disbursement to applicants; and
- Develop written procedures to assist department staff in processing federal expenditure claim schedules and requesting federal reimbursement.

Appendix

U.S. Department of Education

<u>Federal Catalog Number</u>	<u>Program Title</u>
84.181	Special Education—Grants for Infants and Families with Disabilities

Federal Criteria

Drug-Free Workplace

The federal Drug-Free Workplace Act of 1988 directed that, in order to continue receiving federal grants and contracts, the state has to certify that it provides drug-free workplaces and issues drug-free statements to its employees. In response, California's governor issued Executive Order D-58-86 which directed the State Department of Personnel Administration (DPA) to develop policies and guidelines for achieving a drug-free workplace. In turn, the DPA issued Management Memorandum 89-05 that directed state departments to distribute, to all affected employees, Executive Order D-58-86 as well as the Drug-Free Workplace statement that it developed to implement the executive order.

Monitoring of Subrecipients

The Code of Federal Regulations, Title 34, Section 80.40(a), requires grantees to monitor activities to ensure the subrecipients comply with applicable federal requirements and achieve performance goals.

According to the federal Office of Management and Budget (OMB), Circular A-128, state and local governments that allocate \$25,000 or more of federal financial assistance to nonprofit institutions must ensure that the institutions obtain an independent audit that determines whether federal financial assistance was spent in accordance with applicable laws and regulations.

Cost Principles for Indirect Cost Rate Proposals

OMB Circular A-87, Paragraph 839R, Section D(1), requires a proposal for the allocation of costs to support the distribution of indirect costs related to the grant program. Circular A-87, Section J(4)(6), also states that ICRPs must be submitted to a cognizant federal agency for its approval before the department incurs specific costs. Further, the ICRP must be retained at the state government level for audit by a designated federal agency.

In addition, the State Administrative Manual, Section 8756.1, states that each department that receives federal funds must prepare an ICRP in accordance with cost principles published by the federal Department of Health and Human Services. Prior to submitting the proposal to the cognizant federal agency for approval, this section also requires the departments to send their ICRP to the state Department of Finance for review and approval.

Cash Management

The Code of Federal Regulations, Title 31, Section 205.20(a), requires that cash advances to a recipient organization shall be limited to the minimum amounts needed and shall be timed to be in accordance with the actual, immediate cash requirements of the recipient organization in carrying out the purpose of the approved program or project. Also, the timing and amount of cash advances should be as close as administratively feasible to the actual disbursement by the recipient organization.

Employment Development Department

We reviewed the financial operations and related internal controls of the Employment Development Department (department) and the department's administration of the U.S. Department of Labor grants, Federal Catalog Nos. 17.207, 17.225, 17.245, 17.246, and 17.250, and the Federal Emergency Management Agency grant, Federal Catalog No. 83.516.

Issues Reported in Prior Years

The following items were reported in previous years and due to their significance warrant corrective action by the department.

Late Resolution of Audit Reports

The department did not always promptly resolve audit findings noted in audits of subrecipients of Job Training Partnership Act (JTPA) funds. The department's process is to review the audit findings and decide on corrective action for the subrecipient. The subrecipient receives the department's decision in the form of a final determination letter. Under federal regulations, the department is required to resolve audit findings within six months after receipt of a subrecipient's audit report and to begin implementation of corrective action as soon as possible.

We reviewed 44 JTPA subrecipients' audit reports that had final determination due dates during fiscal year 1994-95. For 13 of the 44 reports, the department did not issue final determination letters within 6 months after receiving the reports. In fact, as of March 1996, the department still had not issued final determination letters for these 13 reports, and they were 10 to 19 months late.

Late resolution of audit issues, including administrative findings and questioned costs, can result in additional questioned costs if the subrecipients do not correct deficiencies in their internal controls within a reasonable time frame. In addition, the longer issues of disallowed costs remain unresolved, the greater the risk that money finally determined to be disallowed will not be recoverable. Therefore, the department should strive to issue final determination letters within the six months after receipt of the audit reports.

We have reported a similar issue in prior years. According to the manager of the department's Compliance Resolution Unit, other work has taken a higher priority over resolving subrecipient audit findings. In September 1995, the department did assign a staff person to resolve the backlog of subrecipient audits and has centralized audit resolution issues with this staff person. Nevertheless, the backlog still exists.

Insufficient Monitoring of Subrecipients' Cash Balances

The department has made progress in implementing controls to monitor cash balances of its JTPA subrecipients properly, but it needs to continue these efforts. In prior years, we noted that the department did not have sufficient procedures to monitor these subrecipients' cash balances. In response to our audits, the department planned to perform on-site monitoring reviews to examine the effectiveness of subrecipients' cash management systems.

In addition, the department planned to implement a new computer system that would allow the department to compare subrecipient cash requests against their cash balances. The department intends that its new computer system will ensure that subrecipient cash requests are reasonable and relate to actual immediate needs.

While we found that the department did conduct selected on-site reviews of subrecipients' cash management systems during fiscal year 1994-95, the department has not fully implemented its computer system. The department believes that the cash monitoring component of its computer system will be fully operational by June 30, 1996. Further, the department is currently drafting procedures on oversight of subrecipient cash management. However, because its computer system was not fully operational and it had no formal procedures, the department lacked an important control for ensuring the reasonableness of subrecipient cash requests.

Federal regulations require that the amount of funds transferred to the State be limited to the minimum needed to meet the State's actual, immediate cash needs. Federal regulations also require that cash advances made by the State to subrecipients for the JTPA program conform substantially to the same standards of timing and amount as those that apply to cash advances by the federal government to the State.

Other Instances of Noncompliance With Federal Requirements

In the following instances, the department did not comply with certain federal requirements.

- The department did not always promptly resolve cost compliance issues related to subrecipients that receive JTPA funds. To ensure the proper use of JTPA funds, federal regulations require the department to establish a system for verifying that subrecipients spend JTPA funds within certain limits. Further, federal regulations require the department to implement corrective action in any instances where noncompliance is noted. While the department has a system for identifying subrecipients that are not in compliance with cost limitations, it has not promptly resolved all cost compliance issues. According to a March 1996 status report, 75 previously identified cost compliance issues still await resolution. Of the 75 issues, 48 have been outstanding for four or more years.

In past years, the department assigned resolution of cost compliance issues to various units within its Job Training Partnership Division. However, in September 1995, the department recognized the need for a more efficient and focused method of resolving cost compliance issues. Thus, it centralized the responsibility for resolving these issues by dedicating one staff person within the Compliance Resolution Unit to the task of resolving these issues. This person is now in the process of gathering information and determining options for resolving the 75 outstanding cost compliance issues. Until this is completed, the department cannot take appropriate action to ensure that these cost compliance issues are properly resolved.

- The department is responsible for ensuring that private nonprofit subrecipients of JTPA funds submit audit reports within the required time frames. However, we found that two of the eight nonprofit subrecipients who received JTPA funds submitted their audit reports one and six months late. Thus, the department may be delayed in implementing corrective action.

We have reported a similar issue in prior years. In response to our last audit, the department drafted procedures outlining the steps it will take when a subrecipient does not submit an audit report within the time requirements established under federal regulations. As of March 1996, these procedures were still in draft form.

- Throughout fiscal year 1994-95, the department did not properly reconcile or explain two sections of its quarterly reports showing the expenditures of federal funds for unemployment compensation paid to federal employees and ex-service members. Section A of the report displays summary information of expenditures charged, and Section B details the expenses reported in Section A. For example, we found that its March 31, 1995, quarterly report included a difference between the two sections of this report totaling \$838,000. However, the department did not explain \$181,000 of the \$838,000 difference on the report. The department has continued to research the difference. But, as of March 1996, the department still cannot explain \$34,000 of the \$181,000. Federal administrative procedures require that the department reconcile these two sections. Failure to reconcile may result in overcharges or undercharges to certain federal agencies.

We have reported this issue in prior years. In response, the department formed a task force to resolve this issue. The task force determined that the differences exist because of a time lag between the two systems used to prepare the report. The department intends to explain these differences on each future report. However, as discussed previously, the department was not able to explain or provide support for all of the differences noted on the March 31, 1995, report.

Recommendations

To improve its control and accountability over funds for the JTPA program, the department should take the following steps:

- Ensure that it promptly resolves issues identified in audits of subrecipients and that nonprofit subrecipients submit their audit reports within the required time frames;
- Complete the implementation of the computer system intended to monitor cash balances of subrecipients receiving JTPA funds; and
- Continue its efforts to promptly resolve cost compliance issues.

In order to comply more fully with federal reporting requirements for federal funds received, the department should ensure that its federal financial reports are internally consistent so that relevant sections of reports agree and any differences or discrepancies are adequately explained.

Appendix

U.S. Department of Labor

<u>Federal Catalog Number</u>	<u>Program Title</u>
17.207	Employment Service
17.225	Unemployment Insurance
17.245	Trade Adjustment Assistance—Workers
17.246	Employment and Training Assistance— Dislocated Workers
17.250	Job Training Partnership Act

Federal Emergency Management Agency

<u>Federal Catalog Number</u>	<u>Program Title</u>
83.516	Disaster Assistance

Federal and State Criteria

Monitoring Requirements

Office of Management and Budget (OMB) Circular A-128, Section 14, and Circular A-133, Section 16(b), require the department to make an audit resolution within 6 months after receipt of the audit report and to proceed with corrective action as soon as possible. OMB Circular A-133, Section 15(i), requires that audits be completed and the report submitted no later than 13 months after the end of the State's fiscal year.

The Code of Federal Regulations, Title 31, Section 205.7(d), requires that the amount of funds transferred to the State be limited to the minimum needed to meet the State's actual, immediate cash needs. The Code of Federal Regulations, Title 20, Section 627.430(b), requires that cash advances made to subrecipients for the JTPA program conform substantially to the same standards of timing and amount as apply to cash advances by the federal government to the State.

The Code of Federal Regulations, Title 20, Section 627.445(c)(1), requires the State to establish a system to regularly assess compliance with the cost limitations, including periodic review and corrective action, as necessary.

Reporting Requirements

The U.S. Department of Labor's Employment Security Manual, Part V, Section 9336(D)(3), requires that the totals of the quarterly report of expenditures of federal funds for unemployment compensation paid to federal employees and ex-service members assigned to federal agencies in Section A of the report be equal to the totals generated from the assigned charges in Section B of the report.

Health and Welfare Agency Data Center

We reviewed the financial operations and related internal controls of the Health and Welfare Agency Data Center (data center).

Accounting Weaknesses Cause Inaccurate Financial Statements

The data center did not properly record all assets that it acquired during the year and did not adequately analyze or record certain transactions. For example, the data center did not record approximately \$8.2 million of equipment and software purchased by installment contracts even though the data center had received the equipment and software as of June 30. State administrative procedures require state agencies to record an asset acquired by installment contract in the accounting records as if the asset was purchased at the inception of the contract. Because the data center did not record the equipment and software in its accounting records, it materially understated the net asset and liability accounts in the financial statements.

In addition, the data center recorded approximately \$2.6 million of personal computer equipment in separate “nondepreciable” asset accounts in the financial statements even though the estimated useful life of the equipment was less than four years. State administrative procedures require agencies to expense such equipment when it is acquired. The data center also recorded in its accounting records software totaling approximately \$651,000 even though it had not received the software as of June 30. Furthermore, because the software had an estimated useful life of less than four years, the data center should expense the software when it is received. Finally, the data center improperly capitalized a maintenance service contract for software totaling approximately \$1.3 million. State administrative procedures do not allow agencies to capitalize repair and maintenance costs; rather, these costs should be treated as expenditures when they are incurred.

In addition to improperly recording certain assets, the data center also overstated the cash and accounts payable balances in its financial statements by \$1.8 million. Specifically, the data center included in its cash and accounts payable balances, a special claim schedule submitted to the State Controller’s Office to augment its revolving fund cash. However, the data center had not received nor deposited the cash from the special claim as of June 30. State administrative procedures require state agencies to file a special claim with the State Controller’s Office to augment revolving funds. However, these procedures also require state agencies to record the special claim separately and not include it in the liability account. Finally, the administrative procedures state that the cash should be recorded in the revolving fund as of the date it is deposited.

These weaknesses in accounting for assets and the data center’s failure to properly analyze and record financial information caused material misstatements in the financial statements. As a result, the data center reported inaccurate financial information to the State Controller’s Office, thus reducing the State Controller’s ability to prepare the State’s financial statements accurately and in accordance with generally accepted accounting principles.

Issues Reported in Previous Years

Weaknesses in Control Over Fixed Assets

As we reported last year, the data center has weaknesses in its control over fixed assets. Specifically, the data center has not taken a complete inventory of its fixed assets and reconciled the physical count with the accounting records since July 1990. State administrative procedures require agencies to conduct a physical count at least once every three years and reconcile the physical count with its accounting records. In addition, the data center does not always place property identification tags on its fixed assets. We tested four pieces of equipment and found that three did not have identification tags. State administrative procedures require state agencies to place property identification tags on all state property when practical. The data center's failure to maintain sufficient accountability for its fixed assets prevents prompt detection of errors and exposes state property to increased risk of loss.

Minor Issues of Noncompliance With State Requirements

In the following instances, the data center did not always comply with state administrative requirements:

- As we reported last year, the data center did not prepare and forward to the accounting unit stock received reports for 7 of the 10 purchases of goods we tested. Stock received reports provide the accounting unit with information on the identity, condition, and quantity of goods received;
- The data center did not reconcile its prior year appropriations to balances reported by the State Controller's Office during fiscal year 1994-95; and
- As of December 1995, the data center had not prepared general ledger reports or the related financial reports for the period covering July through September 1995.

Recommendations

To ensure that it prepares accurate financial statements, the data center should:

- Ensure that all equipment and software purchases that are received as of June 30 are properly recorded; and
- Adequately analyze and accurately record transactions prior to preparing the financial statements.

To improve its control over fixed assets, the data center should:

- Perform a physical inventory of its equipment and reconcile the physical count to the accounting records; and
- Apply property identification tags to all equipment when practical.

To improve its system of internal controls, the data center should:

- Prepare and forward to the accounting unit stock received reports;
- Reconcile prior year appropriations to balances reported by the State Controller's Office;
and
- Prepare the general ledger and related financial reports timely.

State Criteria

Financial Reporting Requirements

The State Administrative Manual, Section 8632, requires state agencies to record assets acquired by installment contract in the accounting records as if the asset was purchased at the inception of the contract. In addition, Section 8621 provides the basic accounting rules for fixed assets, and Section 8660 requires state agencies to report fixed assets in the year-end financial statements.

The State Administrative Manual, Sections 8602 and 8603, requires state agencies to expense an asset that has, among other criteria, a normal useful life that is less than four years when the asset is acquired.

The State Administrative Manual, Section 8618, states that repair and maintenance costs should not be capitalized; rather, these costs should be treated as expenditures.

The State Administrative Manual, Section 8170, requires state agencies to record in the revolving fund as of the date of deposit, the cash received from the State Controller's Office from a special claim to augment the revolving fund. Furthermore, Section 10501 states that this special claim should be recorded separately and not included in a liability account.

The State Administrative Manual, Section 7951, requires state agencies to prepare quarterly financial reports, excluding the quarter ending June 30, by the 15th day of the month following the end of the quarter.

Internal Control Requirements

The Government Code, Sections 13401 and 13403, requires state agencies to maintain an effective system of internal controls that includes recordkeeping procedures to provide effective accounting control over assets, liabilities, revenues, and expenditures.

The State Administrative Manual, Section 8652, requires state agencies to conduct a physical count of all property and to reconcile the physical count with the accounting records at least once every three years.

The State Administrative Manual, Section 8651, requires state agencies to place property identification tags on all state property when practical.

The State Administrative Manual, Section 8422.20, requires the state agency's receiving department to forward directly to the accounting unit an original stock received report or a signed copy of the purchase order used as a stock received report on the day the goods are received.

The State Administrative Manual, Section 7959, requires agencies to reconcile with the State Controller's balances, any prior year appropriations that are no longer available for encumbrance and have not reverted.

Department of Health Services

We reviewed the financial operations and related internal controls of the Department of Health Services (department) and the department's administration of the U.S. Department of Agriculture grant, Federal Catalog No. 10.557, and the U.S. Department of Health and Human Services grants, Federal Catalog Nos. 93.565, 93.566, 93.777, 93.778, 93.917, and 93.994.

Summary

We reviewed the financial operations and related internal controls of the department and the department's administration of the U.S. Department of Agriculture and the U.S. Department of Health and Human Services grants. We noted the following concerns during our review:

- The department overstated its accruals by nearly \$900 million in its financial reports for fiscal year 1994-95 for the Health Care Deposit Fund, General Fund, and Federal Trust Fund.
- The department has weaknesses in its controls over the purchasing of goods and services.
- The department has weaknesses in its controls over its monitoring of Medical Assistance Program (Medi-Cal) claim reimbursements.
- The department lacks procedures to track certain costs for the HIV Care Formula Grants program.
- The department has poor controls over its \$280 million of Drug Rebate Program receivables.
- The department's procedures for administering the Special Supplemental Food Program for Women, Infants, and Children (WIC) do not ensure that the program meets all federal requirements.
- The department did not sufficiently monitor the audit reports of nonprofit subrecipients.
- The department's financial reports for the Refugee and Entrant Assistance—State Administered Programs grant do not agree to the accounting records by \$7.3 million.

The Department Did Not Always Prepare Accurate Financial Reports

The department did not accurately prepare its financial reports for fiscal year 1994-95 for the Health Care Deposit Fund, General Fund, and Federal Trust Fund. During our audit, we noted the following conditions:

- The department overstated its accrual, related to projections for Medi-Cal costs, by \$703 million at June 30, 1995. It did not analyze its estimate of services performed in the prior year, fiscal year 1993-94, that were still owed. Instead, it inaccurately accrued

the remaining balance of its prior estimate. As a result, the department overstated receivable and liability accounts for the Health Care Deposit Fund and the Federal Trust Fund and liability accounts for the General Fund.

- The department posted an accrual twice and, as a result, overstated its due from other funds account by approximately \$180 million and its due to other governments account by approximately \$180 million in the Health Care Deposit Fund. In addition, the error of \$180 million resulted in the overstatement of receivable and liability accounts of the department's Federal Trust Fund.
- The department did not ensure that all amounts for the AIDS Drug Assistance Program were accrued in the General Fund. During our testing of accounts payable, we found that the department correctly accrued the federally funded portion of the accounts payable but that it overlooked the accrual for the State's portion of the program. As a result, the department understated its accounts payable and expenditure accounts in the General Fund by approximately \$6.8 million.
- The department did not remove from its accounts payable listing contracts totaling approximately \$1.7 million and \$350,000 for the Maternal and Child Health Program and the Office of AIDS, respectively, even though the service period for these contracts ended on June 30, 1994, and the department expected to make no more payments. As a result, the department overstated its liability and expenditure accounts at June 30, 1995.
- The department's automated files of data related to contracts, such as amounts paid and amounts owed, that provide the support for a portion of its liability and receivable account balances in the Health Care Deposit Fund were not always accurate at June 30, 1995. For example, the department included 39 contracts totaling approximately \$448 million twice, causing an overstatement in its accounts payable, due to other funds, and due to local governments accounts. In addition, individual contracts included in the department's automated file of amounts owed to local governments were overstated. To correct these misstatements, rather than reviewing each individual contract and reducing the balance accordingly, the department inappropriately recorded a mock contract with a negative balance in order to offset the balances in total. Finally, five of the amounts recorded as being owed from other funds in the Health Care Deposit Fund contained discrepancies.

State administrative procedures require state agencies to record as valid receivables all amounts that are due and payable to the department and, at June 30, to accrue those receivables that were not billed previously or accrued but that are expected to be collected within the ensuing year. In addition, the state administrative procedures require agencies to record as liabilities only those amounts relating to valid obligations as of June 30.

Failure to accurately analyze and report financial information submitted to the State Controller's Office reduces the ability of the State Controller's Office to prepare the State's financial statements accurately and in accordance with generally accepted accounting principles.

The Department Did Not Always Have Sound Purchasing Procedures

The department has weaknesses in controls over its purchasing of goods and services. We identified the following specific conditions:

- The department has been unable to reconcile the invoices of airline service providers with the listing of approved service requests maintained by the department's travel agent. When properly working, a computerized reconciliation system matches each airline invoice line item to an approved travel agent line item. The department has continued to pay charges as presented on the airline invoices even though it has not reconciled the invoices. Without this reconciliation, the department has no assurance that the airline services included in the invoice were approved and paid only once.
- During our test of 79 payments from various programs at the department, we found that 19 of the payments were approved by program staff members who did not have proper authorization on file in the accounting office. The signature card on file for the staff authorizing 11 of the payments indicated that the staff members who approved the payments had limited approval authority for an unrelated program. For the remaining 8 payments, the accounting office did not have any authorization card on file for the staff members who authorized them.
- The department paid one invoice for the full amount even though the shipping receipt indicated that three items included in the shipment were damaged and that the payment should be reduced accordingly.

State law requires departments to maintain an effective system of internal control, which includes procedures that provide for effective control over assets, liabilities, revenues, and expenditures.

The Department Has Weak Controls Over Medi-Cal Claim Reimbursements

The department did not have adequate controls in place to ensure that provider claim documents were certified appropriately, that providers held the appropriate certification needed to provide the service performed, or that prior authorization documents were valid. We found the following specific deficiencies:

- For 4 of the 35 Medi-Cal provider claims we reviewed, the claim documentation did not contain evidence of the provider's statement and signature certifying the authenticity of the claim information. Providers for 3 of the 4 claims had claim agreements on file for a different method of claim submission; therefore, these claims should have included a signed provider certification statement with the billing document submitted. Although the fourth provider had a current claim agreement on file, the claim document was prepared electronically using a new federal format which did not allow enough space for the required certification statement.

- Another 2 of the 35 Medi-Cal provider claims we reviewed did not contain the required certification indicating that the provider lab or provider physician was lab proficiency certified for the procedure performed. Although the provider may have been qualified to perform the procedure, the required certification was not on file.
- For one pharmacy claim that required prior approval from the department through a Treatment Authorization Request (TAR), the TAR supporting the claim authorized only five refills of the drug prescription, but the claim we identified represented the sixth refill of the prescription. In addition, the current TAR status did not indicate that any of the prescriptions had been filled. The department's corrective action plan notice dated January 22, 1996, indicates that the problem has since been resolved.

State regulations and department policy require provider certification of all claim document information and stipulate procedure codes that require lab code certification.

The Department Lacks Procedures To Track Certain Federal Costs

The department did not track certain costs for the HIV Care Formula Grants program. Federal regulations limit to 5 percent each the amount of the HIV Care Formula Grants award that can be spent on administrative costs and planning and evaluation costs. In addition, federal regulations require the department to ensure that at least 15 percent of the grant funds are allocated to infants, children, women, and families with the HIV disease. However, the department did not separately track its administrative costs and planning and evaluation costs. Instead, for fiscal year 1994-95, the department combined these costs in its accounting system. When it reported these costs to the federal government, the department evenly divided the total \$1.4 million between administrative costs and planning and evaluation costs. However, for fiscal year 1995-96, the department corrected this situation by establishing two codes to capture this information separately in its accounting system. In addition, we could not determine whether at least 15 percent of the grant funds were used to provide services to infants, children, women, and families with the HIV disease because the department did not track these costs. Without tracking these costs, there is no assurance that the department is complying with the program's spending requirements.

Issues Reported in Prior Years

The following issues were reported in previous years and due to their significance warrant corrective action by the department.

The Department Lacks Adequate Control Over Its Drug Rebate Program Receivables

The department did not follow State Administrative Manual procedures to account for and collect receivables related to the Drug Rebate Program. According to the department's records at June 30, 1995, these receivables totaled approximately \$280 million. We found the following specific conditions:

- The department did not have policies or procedures for monitoring and collecting accounts receivable. Without adequate procedures for monitoring and collecting accounts receivable, the department increases the risk that some receivables will become uncollectable.
- The department did not perform a monthly reconciliation between the subsidiary accounts receivable ledger and the general ledger account. Without properly prepared reconciliations, the department lacks the assurance that the transactions have been recorded properly and that the financial records are complete.

Although the department has improved some of the internal control weaknesses reported previously, it has yet to implement a system that provides for accurate reporting of drug rebates and prompt collection of accounts receivable.

***Procedures Used To Administer
the WIC Program Do Not
Ensure Program Compliance***

The department is not complying with requirements of the federal WIC program. Specifically, the department has implemented procedures to prevent and detect instances of dual participation in the WIC program; however, these procedures did not promptly identify dual participants. In July 1987, the department suspended its existing procedures for detecting dual enrollment because the procedures did not operate as intended and produced inaccurate reports. In December 1993, the department decided to implement an interim system to detect dual participation until an automated system under development became operational. Under the interim system, the department produces a report once a year that identifies potential instances of dual participation. This report is forwarded to the local agencies, which investigate the potential dual enrollment and report back to the department. In November 1994, the department distributed its first dual participation report, pertaining to participant activity in December 1993, to the local agencies for review. However, since the report contained outdated information, the local agencies were unable to effectively use this report to identify current dual participants. Federal regulations require the department, in conjunction with the local agencies, to prevent and detect instances of dual participation.

In addition, the department cannot document that it adequately notifies all local agencies who distribute WIC food vouchers of unauthorized vendors and cannot document that it requested all local agencies to return any unauthorized vendor cards. For 2 of the 22 potential unauthorized vendors tested, we found that the department could not provide us with evidence that it notified the appropriate local agencies that these vendors were no longer authorized to participate in the WIC program. In addition, it cannot provide documentation that it requested these local agencies to return the vendor cards. As a result, the local agencies continued to issue food vouchers for these unauthorized vendors. For the remaining 20 vendors, the department had evidence that it notified local agencies of 10 of the unauthorized vendors and had explanations for the other 10 vendors indicating why a notification was unnecessary. Federal regulations require that only vendors authorized by a state agency may redeem food instruments and that the state agency shall ensure that all participating food vendors have written contracts or agreements with the State. In addition, the WIC state plan states that the department will notify local agencies of the vendors deleted from the WIC program.

According to the chief of the automated management section at the WIC branch, the department is implementing a new on-line eligibility system that will be used to administer program benefits. This new system will allow the local agencies to determine immediately whether an applicant is already receiving benefits, thus identifying any instances of dual participation. The chief stated that this portion of the system will be fully implemented in June 1996. In addition, the system will allow local agencies who issue food vouchers to determine if a vendor is authorized to participate in the program. This portion of the program is expected to be fully implemented in December 1996. As of March 1996, 72 of the 82 local agencies are using the on-line system to certify individuals, including the identification of dual participants, and 6 of the 82 local agencies are using the system to issue checks to authorized vendors.

Insufficient Monitoring of Audit Reports for Nonprofit Subrecipients

The department did not sufficiently monitor the audit reports of nonprofit subrecipients. More specifically, we identified 76 subrecipients—44 participating in the Maternal and Child Health Services Block Grant to the States program, 29 participating in the HIV Care Formula Grants program, and 3 participating in both—that should have submitted audit reports to the department and found the following:

- The department was unable to provide us with 40 of the 76 audit reports that should have been submitted to the department. Further, the department had not included 33 of these 40 nonprofit subrecipients in the database it uses to monitor the receipt of required reports from subrecipients. Finally, the department sent both a late notice and a reminder notice to only 1 of the 40 subrecipients. Without the audit reports and a comprehensive database to track subrecipients, the department lacks the assurance that the nonprofit subrecipients are complying with federal laws and regulations.
- Of the 36 audit reports that the department did receive, 17 audit reports were not received within the time frame established by the State, and 2 of these were not received within the longer time frame established by federal regulations. In addition, the department did not review within six months 15 of the 36 reports that it did receive. Without prompt review of the reports, the department cannot ensure that it resolves audit findings within the required time frame.

State and federal regulations establish deadlines for the submission of the required audit reports. In addition, federal regulations require the State to resolve audit findings within six months after receiving the audit reports.

Federal Financial Status Report Not Reconciled

The department did not reconcile its federal financial status report for the Refugee and Entrant Assistance—State Administered Programs grant for fiscal year 1994-95 with its accounting records. Specifically, the department reported approximately \$28.7 million of expenditures on the federal financial status report, \$7.3 million more than it recorded in its accounting records. Because it had not prepared a reconciliation, the department could not explain the difference between the accounting records and the federal financial status report. Further, we could not determine whether the difference resulted from reconciling items or from errors. However, if the accounting records are correct and the federal financial status report is incorrect, the

department may owe the federal government the \$7.3 million difference since, during fiscal year 1994-95, the department requested and received from the federal government almost all of the \$28.7 million included on the federal financial status report.

Federal regulations require the department to prepare financial status reports that indicate the amount of grant funds received and spent. In addition, state regulations require the department to reconcile federal financial reports with the accounting records.

Failure To Obtain Federal Reimbursements Promptly

State administrative procedures require state agencies to secure prompt reimbursement from grant funds for goods and services provided. However, during fiscal year 1994-95, the department did not promptly obtain reimbursement from the federal government for the Refugee and Entrant Assistance—State Administered Programs and the Maternal and Child Health Services Block Grant to the States program, resulting in a loss of potential interest earnings to the State of approximately \$113,000 and \$110,000, respectively.

Other Instances of Noncompliance With Federal and State Requirements

The following are instances for which the department did not comply with certain federal or state requirements:

- The department has not consistently implemented its Drug-Free Workplace policy. In February 1992, the department established procedures requiring all new employees to sign a Drug-Free Workplace statement to be kept in their personnel files. We found that four of seven employees hired after February 1992 did not have signed Drug-Free Workplace statements on file.
- The department did not return to the federal government federal funds that it requested in error for the HIV Care Formula Grants program. Instead, the department offset subsequent claims against the excess federal funds until the balance was depleted. As a result, the department maintained cash balances ranging from approximately \$69,000 to \$1.9 million during the period between July 1 and August 30, 1994.
- The department did not obtain approval from the Department of Finance before advancing approximately \$284,000 on a contract totaling \$1.1 million.

Recommendations

To ensure that it submits accurate financial statements to the State Controller's Office, the department should do the following:

- Adjust the Medi-Cal accrual related to the prior year appropriation based on current projections of the remaining liability;
- Ensure that each accrual is correctly posted once and only once; and

- Ensure that the information on the automated files of data related to contracts correctly supports the general ledger totals.

To improve its controls over its purchasing of goods and services, the department should:

- Reconcile the invoices of airline service providers with the listing of approved service requests;
- Ensure that it maintains on file in the accounting office the proper signature cards for those employees authorized to approve payments; and
- Ensure that it reviews shipping receipts and does not pay for damaged goods that it returned.

To properly monitor the reimbursement of Medi-Cal claims, the department should do the following:

- Ensure that provider agreements on file are for the method of claim submission used by the provider;
- Ensure that current lab certifications are on file; and
- Ensure that drug prescriptions are correctly counted to limit prescription refills to the number allowed by the approved TARs.

To ensure that it complies with federal regulations, the department should track costs for the HIV Care Formula Grants program.

To properly monitor its Drug Rebate Program receivables, the department should continue to develop and implement a comprehensive policy for monitoring, reconciling, and collecting accounts receivable.

To ensure that it complies with requirements regarding services allowed for the WIC program, the department should do the following:

- Continue its efforts to establish and implement reliable procedures to prevent and detect instances of dual participation; and
- Ensure that it notifies local agencies not yet on the new system of all unauthorized vendors and that local agencies return any unauthorized vendor cards.

To improve its monitoring of subrecipients' audit reports, the department should do the following:

- Ensure that it includes all nonprofit subrecipients in the database that it uses to monitor the receipt of the required reports;
- Ensure that nonprofit subrecipients submit audit reports within the time frames established by state and federal regulations; and

- Ensure that it resolves the audit findings within six months after receiving the report.

To properly prepare its financial status report for the Refugee and Entrant Assistance—State Administered Programs grant, the department should reconcile the financial status report to its accounting records.

To ensure that the State does not lose interest earnings, the department should request federal reimbursements of program expenditures promptly.

Appendix

U.S. Department of Agriculture

<u>Federal Catalog Number</u>	<u>Program Title</u>
10.557	Special Supplemental Food Program for Women, Infants, and Children

U.S. Department of Health and Human Services

<u>Federal Catalog Number</u>	<u>Program Title</u>
93.565	State Legalization Impact Assistance Grants
93.566	Refugee and Entrant Assistance—State Administered Programs
93.777	State Survey and Certification of Health Care Providers and Suppliers
93.778	Medical Assistance Program
93.917	HIV Care Formula Grants
93.994	Maternal and Child Health Services Block Grant to the States

Federal and State Criteria

Accounting and Internal Controls

The State Administrative Manual, Section 7800, requires the department to reconcile subsidiary ledgers with the general ledger each month.

The State Administrative Manual, Section 8776.2, requires the department to accrue, at June 30, those receivables that were not billed previously or accrued but are expected to be collected within the ensuing year.

The State Administrative Manual, Section 8776.6, states that each department will develop collection procedures that will ensure the prompt follow-up on receivables.

The State Administrative Manual, Section 10544, requires agencies to record as liabilities only those amounts relating to valid obligations as of June 30.

The California Government Code, Section 11019, requires the department to obtain the approval of the Department of Finance before granting any advance payments to its contractors with a total annual contract amount exceeding \$400,000.

The California Government Code, Sections 13402 and 13403, requires agencies to maintain an effective system of internal control that includes recordkeeping procedures to provide effective accounting controls over assets, liabilities, revenues, and expenditures.

Medi-Cal Regulations

The California Code of Regulations, Title 22, Sections 51502 and 51502.1, requires that the provider's signature, certifying the accuracy of the billing information, be included on or attached to each billing form and requires that claims submitted electronically shall not be processed until a separate claim certification statement has been verified.

The California Code of Regulations, Title 22, Section 51159, authorizes the department to apply utilization controls, in the form of TARs, as necessary.

The department's Operating Instruction Letter #245-94 implemented current federal regulations that stipulate the procedure codes requiring lab code certification.

HIV Care Formula Grants Regulations

The United States Code, Title 42, Subchapter XXIV, Section 300ff-22(b), requires the department to use not less than 15 percent of the funds allocated to provide health and support services to infants, children, women, and families with the HIV disease.

The United States Code, Title 42, Subchapter XXIV, Section 300ff-28(c)(3) and (4), requires the department to use not more than 5 percent of the amount received for planning and evaluation costs and not more than 5 percent for administrative costs.

WIC: Types of Services Allowed

The Code of Federal Regulations, Title 7, Section 246.7(k), requires the department, in conjunction with the local agency, to prevent and detect instances of dual participation.

The Code of Federal Regulations, Title 7, Section 246.12(e) and (f), requires that only vendors authorized by the state agency may redeem food instruments and that the state agency shall ensure that all participating food vendors have written contracts or agreements with the State.

The WIC state plan states that the department will notify local agencies of the vendors deleted from the WIC program.

Monitoring Requirements

The contracts between the State and nonprofit subrecipients establish a deadline of 5 months and 15 days after the end of the subrecipient's fiscal year for the submission of the required audit reports.

The Office of Management and Budget (OMB), Circular A-133, requires the subrecipients to submit copies of the audit reports to the State within 30 days after the audit is completed and no later than 13 months after the end of the subrecipients' fiscal year.

OMB Circular A-133 also requires the State to resolve audit findings within six months after receiving the report.

State and Federal Cash Management Requirements

The Code of Federal Regulations, Title 31, Section 205.20(a), requires that cash advances to a state be limited to the minimum amounts needed and be timed to be in accordance with the actual, immediate cash requirements of the state.

The State Administrative Manual, Section 911.4, requires agencies to secure prompt reimbursement from grant funds for goods and services provided.

Federal and State Reporting Requirements

The Code of Federal Regulations, Title 45, Section 74.73(a) and (b), requires the department to prepare financial status reports that indicate the amount of grant funds received and spent.

The State Administrative Manual, Section 20014, requires agencies receiving federal funds to reconcile federal financial reports with the official accounting records.

Department of Rehabilitation

Our contracted auditors, Deloitte & Touche, reviewed the Department of Rehabilitation's (department) administration of the U.S. Department of Education's Rehabilitation Services—Vocational Rehabilitation Grants to States, 84.126.

The department did not always comply with federal and state administrative requirements. Of the 25 client case files reviewed, 12 contained at least one deviation from these requirements. These identified deviations were:

- Six client case files did not include support that the counselor had either completed a evaluation of the client's progress at least every 90 days as required or recorded a note in the case file stating the reason why an evaluation was not timely completed;
- Five client case files did not include support that an Individual Written Rehabilitation Plan was established within 90 days of the intake interview and did not support that a continuation was authorized by the rehabilitation supervisor as required;
- Five client case files did not include support that an applicant's eligibility was determined within 60 days of the initial application as required;
- Five client case files did not include a client signature or other support that would demonstrate that the client participated in the development of the Individual Written Rehabilitation Plan as required;
- Three client case files did not include support for an annual review of the Individual Written Rehabilitation Plan as required;
- Two client case files did not include support that the client and counselor followed a stipulation in the Individual Written Rehabilitation Plan requiring monthly meetings between the client and the counselor.

These deviations represent noncompliance with federal regulations that are designed to protect the public's resources from abuse.

Recommendation

The department should implement procedures to ensure that it achieves compliance with the federal and state requirements related to client case file administration.

Appendix

U.S. Department of Education Grant

<u>Federal Catalog Number</u>	<u>Program Title</u>
84.126	Rehabilitation Services—Vocational Rehabilitation Grants to States

Department of Social Services

We reviewed the financial operations and related internal controls of the Department of Social Services (department) and the department's administration of the U.S. Department of Agriculture grants, Federal Catalog Nos. 10.551 and 10.561; the Federal Emergency Management Agency grant, Federal Catalog No. 83.516; and the U.S. Department of Health and Human Services grants, Federal Catalog Nos. 93.560, 93.561, 93.563, 93.565, 93.566, 93.574, 93.645, 93.658, 93.659, 93.667, and 93.802.

Summary

We reviewed the financial operations and related internal controls of the department and its administration of certain U.S. Health and Human Services, U.S. Department of Agriculture, and Federal Emergency Management Agency grants. We noted the following concerns during our review:

- The department needs to improve its monitoring of audit reports of nonprofit subrecipients receiving federal funds;
- The department still does not have a process in place to reconcile its federal financial status reports with its accounting system; and
- The department did not accurately report its draws of federal funds under the Cash Management Improvement Act (CMIA).

Improvements Needed Over Monitoring of Audit Reports

The department needs to improve its monitoring of audit reports of nonprofit subrecipients. Under federal regulations, the department is responsible for ensuring that nonprofit subrecipients obtain an independent audit and that instances of noncompliance with federal laws and regulations are promptly resolved. The department has delegated this responsibility to the various program units that contract with nonprofit organizations. We identified five program units that contract with nonprofit subrecipients. Specifically, the units that administer the Refugee and Entrant Assistance, Job Opportunities and Basic Skills Training, Emergency Food Assistance Program, Adoption Assistance, and the Temporary Child Care and Crisis Nurseries programs contract with nonprofit organizations. We reviewed the process that the department's program units follow to monitor 18 nonprofit organizations' compliance with audit requirements and found the following:

- Prior to our inquiries, none of the program units had formal procedures for reviewing audit reports. Moreover, the informal procedures for the Emergency Food Assistance Program and Temporary Child Care and Crisis Nurseries programs were inadequate for performing this review.

- The program units did not always obtain information from the independent auditors regarding instances of noncompliance with federal laws and regulations or internal control deficiencies. We identified one subrecipient from each program, except for the Refugee and Entrant Assistance program, whose audit reports indicated that findings had been separately communicated to the subrecipient. However, the program units did not obtain these findings for review.
- We reviewed the audit reports of the nonprofits and found that two were not prepared in accordance with federal audit guidelines. Specifically, we identified one audit report each for the Adoption Assistance and Temporary Child Care and Crisis Nurseries programs that contained only financial statements and related information, but lacked the required reports and assurances regarding compliance with federal laws and regulations. Moreover, the department staff of these two programs had not identified that the audit reports were incomplete.
- The program units had audit reports for most of the nonprofit subrecipients that we reviewed. However, for the Emergency Food Assistance Program, the department did not have an audit report for one of the nonprofit organizations that we reviewed.

Without an adequate review process for monitoring audit reports of nonprofit subrecipients, the department lacks assurance the subrecipients are complying with federal laws and regulations and that federal grant money is being spent appropriately.

Federal regulations require the department to ensure that nonprofit subrecipients receiving more than \$25,000 in federal financial assistance have independent audits that meet certain requirements. These requirements include reports on the subrecipients' internal controls, compliance with federal laws and regulations, and audit findings related to federal funds. In addition, federal regulations require the department to ensure that, within six months after receipt of the subrecipient audit reports, nonprofit subrecipients take appropriate corrective action on findings regarding instances of noncompliance with federal laws and regulations.

Inaccurate Reporting Under the Cash Management Improvement Act

The department did not ensure that it correctly reported all federal receipt and disbursement information to the Department of Finance (DOF). The DOF is responsible for implementing the federal CMIA. Under the CMIA, the State generally will incur an interest liability for the amount of time that it holds federal funds. Conversely, the federal government will generally incur an interest liability for the amount of time that the State uses its own funds before receiving federal funds. The DOF is also responsible for submitting an annual cash management report to the federal government containing its calculation of interest liability. State agencies are required to report certain information to the DOF related to their federal program receipts in quarterly cash management worksheets which are used by the DOF in its calculation of interest liability. However, we noted several errors in the department's quarterly worksheets.

Specifically, the department did not report the correct amount of draw downs in its worksheets related to payroll expenditures. The DOF instructions require the department to report the actual amount of each draw of federal funds related to payroll. However, the department combines its draws for payroll and operating expenditures but does not separately identify

the amount of the draw related to each. Therefore, throughout fiscal year 1994-95, the department reported the amount of the payroll expenditures instead of the actual amount of federal funds drawn. As a result, the department's worksheets do not reflect the correct amount of federal funds drawn. For example, in our sample of 20 draws, we noted 5 instances in which the department did not make an initial draw of federal funds for its payroll expenditures. But, because the department reported the amount of payroll expenditures, it reported that it drew federal funds when it did not. In addition, for another 5 draws, the amount of the draws was less than the amount of the payroll expenditures. However, the department still reported the amount of the payroll expenditures rather than the amount of draws. Moreover, because the department did not separately identify the amount of each draw related to payroll, we could not determine the effect on the interest liability calculation.

The department made several errors in reporting other draws of federal funds. For example, the department did not report a draw of \$815,000 for local assistance expenditures. In addition, for all payroll draw downs of the October 1994 pay period, the department reported that it held federal funds for six days, when it actually held the funds for seven days. For another draw, the department reported that the federal government owed the State zero days of interest when the federal government actually owed 15 days of interest. Finally, for one more draw, the department reported that the State owed the federal government zero days of interest when the State actually owed one day of interest. As a result of these reporting errors, the department did not report that the federal government owed the State interest of approximately \$67,000.

Insufficient Monitoring of Federal Programs

The department did not sufficiently monitor counties participating in the Refugee and Entrant Assistance and Child Support Enforcement programs. We reviewed the department's monitoring for these programs during fiscal year 1994-95 and found the following issues:

- The department did not meet its goals for monitoring the 14 counties that participated in the Refugee and Entrant Assistance program. This program provides grants for cash assistance, medical assistance, and related administration and for social services programs. The department has agreed with the federal government to review each participating county every two years. Further, the department's internal goal is to monitor all participating counties each fiscal year. However, during fiscal year 1994-95, the department only monitored three counties receiving grants for cash assistance, medical assistance, and related administration and another three counties receiving grants for social services programs. Moreover, the department did not monitor all participating counties during the two-year period covering fiscal years 1993-94 and 1994-95. The department is currently developing a formal monitoring plan and schedule to meet its goals.
- While the department conducted an appropriate level of monitoring of counties participating in the Child Support Enforcement program, it did not verify that the counties had a proper separation of cash and accounting functions. Federal regulations require that the department monitor the operations of subrecipients. The monitoring process is designed to ensure that subrecipients have met the compliance requirements of the program. Federal regulations require that subrecipients separate their cash handling and accounting functions.

Without proper monitoring, the State cannot ensure that counties properly administer the programs in accordance with federal laws and regulations.

Issues Reported in Prior Years

The following items were reported in previous years and, because of their significance, warrant corrective action by the department.

Federal Financial Reports Are Not Reconciled With Accounting Records

The department did not reconcile all its federal financial reports prepared during fiscal year 1994-95 with the departmental accounting records. Failure to reconcile federal financial reports with the accounting records can result in misstated claims that are not supported by the department's accounting records and that may go undetected.

We reported a similar weakness in past years. According to the department's accounting section, the department recognizes the need to implement a reconciliation system that will allow it to reconcile federal financial reports with its accounting records. Since our audit of fiscal year 1993-94, the department has made progress in implementing a reconciliation process. Specifically, the department has been able to reconcile several smaller federal grants to accounting records. The department is continuing with its efforts to develop automated processes and reconciliations.

Federal regulations require that the department maintain accurate accounting records that permit the preparation of reports and tracing of funds, as well as accurate, current, and complete disclosure of financial activities related to the grant. Additionally, state administrative policy requires agencies receiving federal funds to reconcile federal financial reports with the official accounting records and retain all supporting schedules and worksheets for a minimum of three years.

Deficiencies in Cash Management

In addition to incorrectly reporting its draws of federal funds under the CMIA as discussed previously, the department also has deficiencies in the way it manages cash for federal programs. Specifically, the department did not promptly request federal funds to reimburse the State for expenditures incurred, and it maintained balances of federal funds that exceeded its immediate cash needs. We reviewed the department's process for drawing federal funds and found the following:

- The department did not draw down funds from the Social Services Block Grant as soon as it could have. The department receives funding for this grant in quarterly allotments and draws funds from the allotment on a weekly basis. However, for the quarter ending September 30, 1994, the department could have drawn funds totaling \$39 million up to four weeks sooner than it did. Specifically, the department could have drawn \$19.5 million of the \$39 million four weeks sooner and the remaining \$19.5 million one to three weeks sooner than it did. As a result, the State lost interest earnings of approximately \$109,000.

The department did not draw federal funds as quickly as it could have for the September 30, 1994, quarter because staff thought they had to completely draw the previous quarter's allotment of funds before drawing funds for the following quarter. Specifically, the previous quarter's allotment was received late from the federal government, causing the department to be behind in its draws for that quarter. Nevertheless, the department could have drawn funds from the allotment for the quarter ending September 30, 1994, when it received the grant award letter from the federal government.

- The department pays its support expenditures from the general fund and subsequently requests reimbursement for the federal portion of those expenditures. However, the department did not always make good estimates of the federal funds needed to reimburse expenditures it incurred related to 20 draws we reviewed. For example, the department underestimated its cash needs by \$5.67 million for 16 draws reviewed. As a result, the State lost interest income of approximately \$25,200. Conversely, for two other draws, the department overestimated its cash needs by \$2.69 million. As a result, the State earned interest of approximately \$28,700 to which it was not entitled. Because the department did not retain documentation to support its estimates, it could not provide a reasonable basis for the variances we noted between the estimate of its needs and the actual expenditures. While the net amount of interest lost or earned in these instances was not significant, the department needs to estimate more accurately its drawdowns of federal funds against its expenditures to ensure that it neither loses interest nor incurs an interest liability to the federal government.

Federal regulations require the department to minimize the time between transfer of funds from the U.S. Treasury and payment of the expenditures, as well as limit its requests for federal funds to the minimum required to meet the State's immediate needs. We reported a similar issue in prior years.

Other Instances of Noncompliance With Federal Requirements

In the following instances, the department did not comply with certain federal requirements.

Inaccurate Reporting of Time Charges

As we reported in past years, the department does not accurately report to the federal government the time charged by department personnel for the Social Security—Disability Insurance program. For example, we reviewed the time charged to the program by employees of two department branches for the quarter ending March 31, 1995, and found that the department understated the time charged by approximately 3,700 hours. Federal regulations require that the department maintain and furnish to the federal government the records and reports relating to the administration of the Social Security—Disability Insurance program.

No Support for Expenditures on Federal Report

The department could not provide support for expenditures that it reported in the annual reports required for the Child Care for Families At-Risk of Welfare Dependency program. Specifically, in the annual reports for the periods November 1, 1991, through

October 31, 1992, and November 1, 1992, through October 31, 1993, the department reported expenditures of \$27.2 million and \$30.8 million, respectively. Because the department could not provide support for these expenditures, we could not verify their accuracy. Federal regulations require the department to maintain records that identify the source and application of federal funds.

Clerical Errors on Federal Reports

The department made clerical errors on two federal reports we reviewed. Specifically, on its June 30, 1995, Foster Care—Title IV-E financial report, the department did not report approximately \$61,000 in administrative expenditures. In addition, on the March 31, 1995, Job Opportunities and Basic Skills Training (JOBS) program financial report, the department reported \$297,646 in total fiscal year expenditures when the correct amount should have been more than \$29 million. Federal regulations require that the department prepare accurate, current, and complete disclosure for each grant program.

Recommendations

To improve its monitoring over the nonprofit subrecipients, and to ensure that nonprofit subrecipients are in compliance with federal laws and regulations, the department should take the following steps:

- Develop procedures to obtain, review, and assess the completeness of audit reports from its nonprofit subrecipients; and
- Ensure that nonprofit subrecipients correct deficiencies noted in their audit reports.

To ensure that subrecipients spend federal funds in accordance with federal laws and regulations, the department should improve its monitoring of counties participating in the Refugee and Entrant Assistance and Child Support Enforcement programs.

To improve its reporting of draws and disbursements of federal funds to the federal government as required by the CMIA, the department should take the following actions:

- Accurately report the federal funds drawn for payroll expenditures;
- Report the correct date that funds are drawn and warrants are issued for federal programs; and
- Ensure that it reports all federal funds drawn.

To ensure that it maximizes interest earning on federal funds, the department should draw federal funds when the funds are available.

To ensure that it minimizes the amount of time between the draw and disbursement of federal funds, the department should more accurately estimate its needs for federal funds and then draw down the federal funds it needs.

To ensure that it reconciles its federal financial reports with its accounting records, the department should continue with its efforts to develop automated processes and reconciliations.

To ensure that it complies with reporting requirements for its various federal program grants, the department should take the following actions:

- Accurately report the time charged by department personnel for the Social Security—Disability Insurance program;
- Retain support for all amounts reported to the federal government; and
- Minimize the clerical errors contained within its federal reports.

Appendix

U.S. Department of Agriculture

<u>Federal Catalog Number</u>	<u>Program Title</u>
10.551	Food Stamps
10.561	State Administrative Matching Grants for Food Stamp Program

Federal Emergency Management Agency

<u>Federal Catalog Number</u>	<u>Program Title</u>
83.516	Disaster Assistance

U.S. Department of Health and Human Services

<u>Federal Catalog Number</u>	<u>Program Title</u>
93.560	Family Support Payments to States—Assistance Payments
93.561	Job Opportunities and Basic Skills Training
93.563	Child Support Enforcement
93.565	State Legalization Impact Assistance Grants
93.566	Refugee and Entrant Assistance— State Administered Programs
93.574	Child Care for Families At-Risk of Welfare Dependency
93.645	Child Welfare Services—State Grants
93.658	Foster Care—Title IV-E
93.659	Adoption Assistance
93.667	Social Services Block Grant
93.802	Social Security—Disability Insurance

Federal and State Criteria

Monitoring

The Office of Management and Budget (OMB), Circular A-133, requires the department to ensure that nonprofit subrecipients receiving more than \$25,000 in federal financial assistance have independent audits that meet certain requirements. These requirements

include reports on the subrecipients' internal controls, compliance with federal laws and regulations, and audit findings related to federal funds. In addition, OMB Circular A-133 requires the department to ensure that, within six months after receipt of the subrecipient audit report, nonprofit subrecipients take appropriate corrective action on findings regarding instances of noncompliance with federal laws and regulations.

In the department's quarterly performance reports to the federal government, the department states that its goal is to monitor participating counties every two years. Further, according to the program manager of the department's Refugee Operations Section, the department's internal goal is to monitor all participating counties each year.

The Code of Federal Regulations, Title 45, Section 400.22, requires the State to have a systematic, planned examination and evaluation of the counties' administration of the Refugee and Entrant Assistance program.

The Code of Federal Regulations, Title 45, Section 304.20, requires the department to monitor the operations of Child Support Enforcement subrecipients. The Code of Federal Regulations, Title 45, Section 302.20, requires that the grantees separate their cash handling and accounting functions.

Cash Management

The Code of Federal Regulations, Title 31, Section 205.7(b), requires the State to minimize the time elapsing between the transfer of funds from the U.S. Treasury and the payout of funds for program purposes by the State. Additionally, the Code of Federal Regulations, Title 31, Section 205.7(d), requires that the amount of funds transferred to the State be limited to the minimum required to meet the State's actual, immediate cash needs.

The State Administrative Manual, Section 0911.4, requires state agencies to secure prompt reimbursement from grant funds for goods and services provided.

The Code of Federal Regulations, Title 31, Section 205.9(f), requires states that do not have a Treasury-State agreement in effect after the later of June 30, 1993, or the last day of the state's 1993 fiscal year, to follow the default provisions prescribed by the federal government.

The Cash Management Improvement Act Default Procedures for the State of California (default procedures) prescribed by the Secretary of the Treasury state that the Department of Finance (DOF) is responsible, in part, for maintaining a complete and uniform state accounting system. The default procedures also state that the DOF is responsible for implementing the Cash Management Improvement Act (CMIA).

The DOF requires departments to gather information for calculating the CMIA interest liability. The departments are also required to submit this information to the DOF using the CMIA worksheets. The DOF instructions for the worksheets require the department to report the actual amount of each draw of federal funds related to payroll.

Reporting

The Code of Federal Regulations, Title 7, Section 277.6(b) and Sections 74.21(b) and 92.20(b), requires that grantees provide accurate, current, and complete disclosure of each grant the source and application of funds provided for financially assisted activities.

The State Administrative Manual, Section 20014, requires that all state agencies receiving federal funds reconcile federal financial reports to the official accounting records and retain all supporting schedules and worksheets for a minimum of three years.

The Code of Federal Regulations, Title 20, Sections 404.1625 and 416.1025, requires the department to maintain the records and reports relating to the administration of the Social Security—Disability Insurance program. The Code of Federal Regulations, Title 20, Sections 404.1603 and 416.1003, require the department to furnish these reports and records to the federal government.

Legislative, Judicial and Executive

Office of Emergency Services

We reviewed the Governor's Office of Emergency Services' (office) administration of the U.S. Federal Emergency Management Agency Disaster Assistance grant, Federal Catalog No. 83.516.

Summary

We reviewed the office's administration of the U.S. Federal Emergency Management Agency's (FEMA) Disaster Assistance grants. We noted the following concerns during our review:

- The office has neither developed nor submitted its indirect cost rate proposal to the Department of Finance (DOF) or FEMA for fiscal years 1994-95 and 1995-96 even though FEMA has informed the office that claims for indirect costs will be unallowable in periods for which there was no approved indirect cost rate. Currently, the State is at risk of losing at least \$580,000 of federal reimbursement for costs it has incurred.
- The office did not report approximately \$12.4 million in Disaster Assistance Program receipts in the quarterly cash management work sheets it submits to the DOF. Additionally, the office did not always include in these work sheets the federal funds that had been expended.
- The office did not prepare certain quarterly federal financial reports. As a result, it did not report cash transactions of \$5.1 million. Also, the office did not reconcile its federal financial reports prepared during fiscal year 1994-95 with departmental or state accounting records.
- The office does not always adequately monitor the claims it submits to the federal government. We found that, in April 1994, the office submitted a claim to FEMA totaling approximately \$2.0 million for costs incurred related to the Loma Prieta earthquake. However, the office was unable to provide any official documents to show us that the office had taken action to determine the status of this claim since its original submission to FEMA. We reported a similar issue in previous years.
- The office does not always minimize the time between receipt and disbursement of federal funds. We noted 32 instances in which the office was from 1 to 187 days late in disbursing approximately \$60.4 million federal funds.
- The office did not transfer to the State's General Fund, within 30 days of the end of each quarter during fiscal year 1994-95, reimbursements representing the federal government's share of service costs provided by central agencies. Instead, approximately eight and one-half months after the end of the fiscal year, the office transferred the reimbursements for the entire year.

Potential Loss of Federal Funds

The office could potentially lose federal funds for indirect costs incurred under the Disaster Assistance Program because it did not follow federal and state requirements pertaining to indirect cost rate proposals.

The office did not prepare and submit an indirect cost rate proposal to FEMA for fiscal year 1994-95. Moreover, the office did not prepare an indirect cost rate proposal even though FEMA requested this information on several occasions. For example, the office received a letter from FEMA in January 1994, that included a reminder that the office's indirect cost rate proposal for fiscal year 1994-95 was past due. In October 1995, the office received another letter from FEMA which stated that the office did not have approved indirect cost rates for fiscal years 1994-95 and 1995-96. FEMA also informed the office that claims for indirect costs were therefore unallowable and should not be claimed in periods for which there was no approved indirect cost rate.

As of April 1996, the office has not submitted indirect cost rate proposals to FEMA for fiscal years 1994-95 and 1995-96. To date, the office has submitted claims for indirect costs totaling approximately \$580,000 for fiscal years 1994-95 and 1995-96, but the recovery of these costs as well as indirect costs included on future claims may be in jeopardy.

Also, the office failed to submit a final indirect cost rate proposal (final proposal) to the federal government for fiscal year 1993-94. Subsequent to year-end, when actual costs are known, agencies are required to submit a final proposal reflecting actual costs. Once a final proposal is approved, the agency may retroactively amend the claims it made against federal program grants during the fiscal year. Because it did not prepare and submit a final proposal for fiscal year 1993-94, the office cannot determine if it can recover additional indirect costs or if it owes a repayment to the federal government.

The State Administrative Manual requires agencies to prepare their indirect cost rate proposals in accordance with the principles in "A Guide for State and Local Government Agencies Cost Principles and Procedures for Establishing Cost Allocation Plans and Indirect Cost Rates for Grants and Contracts with the Federal Government" (OASC-10). These guidelines state that it is essential that grantees submit their indirect cost rate proposals in a timely manner and require grantees to submit an indirect cost rate proposal at least six months before the start of the fiscal year to which the indirect cost rate proposal applies. In addition, OASC-10 requires grantees to submit a final indirect cost rate proposal after the fiscal year-end when actual costs are known.

Inaccurate Cash Management Reports Submitted to the DOF

The office did not ensure that it reported all Disaster Assistance Program receipts and disbursements to the DOF. The DOF is responsible for implementing the federal Cash Management Improvement Act (CMIA). The DOF uses information obtained from state agencies to calculate the State's interest liability. Failure to provide accurate information to the DOF regarding program receipts and disbursements results in the State providing inaccurate information in its annual report to the federal government. Specifically, for fiscal year 1994-95:

- We found that the office did not reconcile the receipts reported to the DOF with the accounting records. As a result, the office did not report five program receipts totaling approximately \$12.4 million in federal funding received in the quarterly work sheets.
- For certain disasters, the office receives program funds via U.S. Department of the Treasury checks and wires. The office correctly reported the receipt of these program funds in work sheets submitted to the DOF but it did not report the related disbursement information.

Failure To Comply With Federal and State Reporting Requirements

The office did not comply with federal reporting requirements for funds received under the Disaster Assistance Program during fiscal year 1994-95. We noted the following instances of noncompliance:

- For fiscal year 1994-95, the office failed to prepare the required federal financial reports when it received program funds via U.S. Department of the Treasury checks and wires. As a result, cash transactions of at least \$5.1 million were not reported to FEMA. Failure to prepare and submit required federal financial reports restricts the ability of the federal agency to monitor cash advanced to the department and could result in fiscal sanctions from the federal government.
- The office did not perform some required reconciliations during fiscal year 1994-95. Specifically, the office did not reconcile certain federal financial reports prepared during fiscal year 1994-95 with departmental accounting records. Moreover, the office did not reconcile its accounting records with those at the State Controller's Office (SCO). As a result, the office was unaware that the PMS 272 report for the period January 1995 through March 1995 did not include receipts totaling approximately \$27,000 that the accounting records identified. Failure to reconcile federal financial reports with the accounting records can result in misstated amounts in federal reports that are not supported by the office's accounting records. Also, unless it reconciles its accounting records with the SCO records, the office cannot ensure that its accounting records are accurate or complete.

Federal law requires the State to maintain accurate accounting records that permit the preparation of reports and tracing of funds, as well as accurate, current, and complete disclosure of financial activities related to the grant. In addition, the State Administrative Manual requires each agency receiving federal funds to reconcile federal financial reports with the official accounting records and retain all supporting schedules and work sheets for a minimum of three years. The State Administrative Manual further states that properly prepared reconciliations represent an important element of internal control because they disclose some types of errors as they occur both in the agency accounts and in the central accounts maintained by the SCO. The reconciliations thus allow the agency to correct the accounts before the financial statements are prepared.

Issues Reported in Prior Years

The following items were reported in previous years and due to their significance warrant corrective action by the office.

Failure To Adequately Monitor Claims Submitted to the Federal Government

The office does not always adequately monitor the claims it has submitted to the federal government. As a result of our fiscal year 1993-94 audit, we reported that the office had not appealed approximately \$564,000 in identified costs related to the Loma Prieta earthquake that were denied by FEMA. In its May 1995, response to the fiscal year 1993-94 audit, the office stated that it had filed another claim for approximately \$2 million that included the previously denied costs. Also, the office stated that it would make a request to FEMA to determine the status of this claim. However, during our testing for fiscal year 1994-95, we found that even though it had submitted the claim back in April 1994, the office was unable to provide any evidence to show it had communicated with FEMA on the status of the claim.

The State Administrative Manual requires state agencies to secure prompt reimbursement from grant funds for goods and services provided. Consequently, the office should adequately monitor the status of the claims submitted to FEMA.

Delays in Disbursing Federal Funds

The office does not always minimize the time between receipt and disbursement of federal funds. During our review of the office's quarterly cash management work sheets, we noted 32 claims related to the Disaster Assistance Program in which the State was late in disbursing funds. In 25 instances, the State was from 1 to 20 days late in disbursing program funds totaling approximately \$55.1 million; in 6 instances, the State was from 21 to 55 days late in disbursing program funds totaling approximately \$5.3 million; and in 1 instance, the State was 187 days late in disbursing program funds totaling approximately \$8,000. We consider a disbursement late if it is delayed more than 5 days after the receipt of federal funds. Failure to minimize the time between receipt and disbursement of federal funds directly impacts the State's interest liability, which, as previously discussed, is calculated by the DOF as part of its cash management responsibilities.

Federal regulations require that cash advances to a state be limited to the minimum amounts needed and timed to be in accordance only with the actual immediate cash requirements of the state.

Delay in the Transfer of Statewide Cost Allocation Plan Recoveries

The office did not promptly transfer to the State's General Fund reimbursements representing the federal government's share of service costs provided by central agencies. Central service agencies provide services such as financial, personnel, and legal support. These costs are calculated under the Statewide Cost Allocation Plan (SWCAP), which is the plan that each state agency uses to pay for its share of the State's cost for central services. The office did not transfer SWCAP recoveries within 30 days of the end of each quarter as required by the

California Government Code and the State Administrative Manual. Instead, the office transferred all of the SWCAP recoveries for fiscal year 1994-95 on March 15, 1996, approximately eight and one-half months after the end of the fiscal year.

Recommendations

To improve its control and accountability over funds for its Disaster Assistance grant, the office should:

- Prepare and submit its annual indirect cost rate proposal for fiscal years 1994-95 and 1995-96, and its final indirect cost rate proposal for fiscal year 1993-94;
- Monitor all claims submitted to FEMA until the claims are settled;
- Minimize the time between receipt and disbursement of federal funds; and
- Transfer SWCAP recoveries within 30 days after the end of each quarter.

To ensure that it complies with reporting requirements for its Disaster Assistance Program, the office should:

- Ensure that the quarterly cash management work sheets it submits to the DOF are accurate and complete;
- Ensure that it prepares all of the required federal financial reports to FEMA;
- Reconcile federal financial reports to the accounting records every quarter; and
- Reconcile its accounting records with the SCO every month.

Appendix

U.S. Federal Emergency Management Agency Disaster Assistance Grants

<u>Federal Catalog Number</u>	<u>Program Title</u>
83.516	Disaster Assistance

Federal and State Criteria

Cost Principles

The Code of Federal Regulations, Title 44, Section 13.22, requires grantees to determine allowable costs in accordance with the principles in Office of Management and Budget (OMB) Circular A-87.

OMB Circular A-87 requires grantees to prepare an indirect cost rate proposal to be submitted to the grantee's federal cognizant agency for approval.

The State Administrative Manual, Section 8756.1, requires departments to prepare their indirect cost rate proposals in accordance with the principles in "A Guide for State and Local Government Agencies Cost Principles and Procedures for Establishing Cost Allocation Plans and Indirect Cost Rates for Grants and Contracts with the Federal Government" (OASC-10).

OASC-10 states that it is essential that grantees submit their indirect cost rate proposals in a timely manner. Also, it requires grantees to submit an indirect cost rate proposal at least six months before the start of the fiscal year to which the indirect cost rate proposal applies. In addition, OASC-10 requires grantees to submit a final indirect cost rate proposal after the fiscal year-end when actual costs are known.

Cash Management

The Code of Federal Regulations, Title 31, Section 205.9(f), requires states that do not have a Treasury-State agreement in effect after the later of June 30, 1993, or the last day of the state's 1993 fiscal year, to follow the default provisions prescribed by the federal government.

The Cash Management Improvement Act Default Procedures for the State of California (default procedures) prescribed by the Secretary of the Treasury, U.S. Department of the Treasury, states that the DOF is responsible, in part, for maintaining a complete and uniform state accounting system. The default procedures also state that the DOF is responsible for implementing the CMIA.

The DOF requires departments to gather information for calculating the CMIA interest liability. The departments are also required to submit this information to the DOF using the CMIA work sheets.

The Code of Federal Regulations, Title 31, Section 205.20, requires that cash advances to a state be limited to the minimum amounts needed and timed to be in accordance only with the actual immediate cash requirements of the state. The timing and amount of cash advances shall be as close as is administratively feasible to the actual cash outlay by the state.

The State Administrative Manual, Section 0911.4, requires state agencies to secure prompt reimbursement from grant funds for goods and services provided.

The California Government Code, Section 13332.01, requires agencies to recover SWCAP costs from the federal government.

The State Administrative Manual, Section 8755.2, states that a transfer of SWCAP recoveries to the State's General Fund within 30 days of the end of each quarter is appropriate.

Reporting Requirements

The Code of Federal Regulations, Title 44, Section 13.41(c), requires departments to prepare and submit the Report of Federal Cash Transactions no later than 15 working days following the end of each quarter.

Accounting Records

The Code of Federal Regulations, Title 44, Section 13.20, requires the state to maintain accurate accounting records that permit preparation of reports and tracing of funds, as well as the accurate, current, and complete disclosure of its financial activities relating to the federal grant. In addition, the section states that effective control and accountability must be maintained for all grant and subgrant cash, and that actual expenditures or outlays must be compared with budgeted amounts for each grant or subgrant. Finally, the section states that grantees must adequately safeguard such cash and property and must assure that they are used solely for authorized purposes.

The State Administrative Manual, Section 20014, requires departments receiving federal funds to reconcile federal financial reports to the official accounting records and retain all supporting schedules and work sheets for a minimum of three years.

The State Administrative Manual, Section 7900, discusses the importance of reconciliations. Specifically, it states that properly prepared reconciliations represent an important element of internal control because they disclose some types of errors both in the agency accounts and in the central accounts maintained by the SCO so that the accounts can then be corrected before the financial statements are prepared.

We reviewed the financial operations and related internal controls of the Board of Equalization (board).

The Board Does Not Assess Penalties on Underpayment of Required Taxes

The board does not assess penalties on underpayment of required fuel tax prepayments. We reviewed the prepayments made by 14 motor vehicle fuel distributors required to make prepayments. The 14 distributors account for 99 percent of the motor vehicle fuel tax assessments for fiscal year 1994-95. For each of the distributors, we reviewed 4 monthly prepayments for a total of 56 monthly prepayments. We found that distributors underpaid the required amount in three instances. In one instance, although the board detected an underpayment of \$429,900, it did not assess a penalty. In two other instances, because it made an error in calculating the required prepayment, the board did not detect underpayments of \$149,700. Since the board lacked a policy of assessing penalties for underpayment of required tax prepayments and failed to detect underpayments, the board did not assess penalties of at least \$34,800.

We reported a similar finding during the financial audit for fiscal year 1991-92. At that time, the senior auditor for the fuel taxes division stated that there was no provision in law to assess penalties on the underpayment of required taxes. This statement reflected the understanding that the law on assessment of penalties applied only if the distributor filed the prepayment tax return late and that the law did not apply if the distributor underpaid the amount of the prepayment due as long as the distributor filed the tax return on time. However, the board's legal counsel stated in a memorandum dated October 18, 1994, that the law permits the assessment of penalties for any part of the prepayment that is late. According to the deputy director of the Special Taxes Department, beginning in October 1995, the board reviewed all its tax and fee programs that have prepayment provisions to determine if similar penalty provisions existed and how they were applied to underpayments. On April 3, 1996, the deputy director advised us that the review confirmed that the proposed policy for the fuel tax penalty assessments on underpayment of prepayments is consistent with other board tax and fee programs. Therefore, the board now plans to assess penalties on underpayment of required fuel tax prepayments.

State law requires motor vehicle fuel distributors whose estimated tax liability averages \$900,000 or more per month to make a prepayment of taxes each month. Fuel distributors may satisfy the requirement by making a prepayment of at least 95 percent of the tax liability for the month to which the prepayment applies or at least 95 percent of the amount of the tax liability reported for the previous month. Further, state law describes the penalties that are to be assessed on late prepayments.

Recommendation

To improve its control over collection of motor vehicle fuel tax prepayments, the board should ensure that distributors pay the required amount of prepayments, and it should assess a penalty for any part of the prepayment that is late.

State Criteria

Prepayment Requirements

Section 7659.1 of the Revenue and Taxation Code states that any distributor whose tax liability averages \$900,000 or more per month shall make a prepayment as prescribed by this section. Fuel distributors may satisfy the requirement by making a prepayment of at least 95 percent of the tax liability for the month to which the prepayment applies or at least 95 percent of the amount of the tax liability reported for the previous month.

Section 7659.5 of the Revenue and Taxation Code states that any distributor required to make a prepayment who fails to make a timely prepayment shall also pay a penalty of 6 percent of the amount of the prepayment. In addition, Section 7659.7(b) states that if any part of a deficiency in prepayment is due to negligence or intentional disregard of the regulations, a penalty of 10 percent of the deficiency shall be paid.

In a memorandum dated October 18, 1994, the board's legal counsel interpreted Section 7659.5 as permitting the assessment of penalties for any part of the prepayment that is paid late.

Department of Insurance

We reviewed the financial operations and related internal controls of the Department of Insurance (department).

The Department Does Not Reconcile Its Revenue Account

The department does not reconcile its accounting records to those of the State Controller's Office (SCO) for the Insurance Tax Fund. The department receives cash, records revenue in its general ledger, then sends remittance advices to the SCO. The SCO records the remittance advice as revenue in its accounting records. At the close of fiscal year 1994-95, the SCO prepared a reconciliation of its records with those of the department because the department did not. There was an unreconciled difference of approximately \$3 million between the SCO records and the department's records.

Regular reconciliation of a department's accounts with like accounts maintained by the SCO will disclose some types of reporting errors and ensures the accuracy of the department's financial reports. Further, state administrative policies require state agencies to reconcile their revenue accounts with the State Controller monthly within 30 days of the preceding month and to also prepare an annual reconciliation.

Recommendation

To improve its system of internal control, the department should:

- Reconcile its revenue accounts with those maintained by the SCO.

Appendix

State Criteria

Internal Control

The State Administrative Manual, Section 7976, discusses the importance of reconciliations between the agencies and the SCO's records. Specifically, it requires state agencies to reconcile their revenue accounts with the State Controller within 30 days of the preceding month and to also prepare an annual reconciliation.

We reviewed the financial operations and related internal controls of the Department of Justice (department) and the department's administration of the U.S. Department of Justice grant, Federal Catalog No. 16.579, and the U.S. Department of Health and Human Services grant, Federal Catalog No. 93.563.

Actual Costs Not Charged to the Child Support Enforcement Grant

The department did not follow applicable federal cost principles in charging the Child Support Enforcement grant for legal services. The Department of Social Services (DSS) is the principal state agency administering the grant. As part of its administration, the DSS contracts with the department to provide, among other things, legal services in the areas of family law and child support enforcement. These legal services include such tasks as representation of appeals for child support judgments, initiation of appeals of rulings against district attorneys, and developing answers to legal questions having statewide significance. Federal cost principles state that allowable costs for state administration of federal grant programs include direct costs and indirect costs. Direct costs are those that can be identified specifically with a grant program. Indirect costs are those that benefit more than one cost objective and are not readily assignable to a single cost objective.

Rather than charging the grant allowable direct and indirect costs as required by federal cost principles, the department charged the grant an amount based on a rate of \$95 per hour of attorney time. The department did not base this hourly rate on actual costs incurred for supplying legal services, rather, it developed this rate based on estimates of various costs it could incur during the fiscal year. These cost estimates included not only attorney salaries and benefits but also clerical costs, equipment, facilities operations, operating expenses, office furniture, consulting services, personal computers, library books, and "other items of expense." The department's charges to this grant, therefore, reflected only an estimate of the costs it incurred for legal services during fiscal year 1994-95, not the costs it actually incurred.

Because it did not charge the grant an amount based on allowable direct and indirect costs, there is no assurance that the total amount the department charged the grant was proper. During fiscal year 1994-95, the department charged the grant \$208,500. Department records indicate that \$88,600 of these costs are attributable to the salary and benefits of an attorney associated with the Child Support Enforcement program. The department, however, could not demonstrate that the remaining \$119,900 benefited the grant. The department did not charge the grant allowable direct and indirect costs because the hourly rate was the agreed-upon payment method identified in its contract with the DSS.

Attendance Records Not Signed by Employees

The department's billings for attorney fees to the child support enforcement programs are based on reported hours worked. However, the supporting attendance records for the reported hours are not signed by the employees or approved by appropriate supervisory personnel. State requirements specify that when individual attendance records are maintained, they will be

signed by both the employee and the employee's supervisor. Further, this needs to be implemented because the federal guidelines for federal grants effective for fiscal year 1996-97, require that attendance records be signed by employees.

Issues Reported in Prior Years

The following items are similar to those reported in previous years and due to their significance warrant corrective action by the department.

Billings Not Issued Promptly

The State lost interest earnings of approximately \$13,000 because of the department's late billings to the DSS for services provided under the Child Support Enforcement grant. The DSS does not collect the federal funds for the Child Support Enforcement grant until it receives the department's billings. Thus, when the department's billings are late, the State loses interest. Specifically, the department provided services for this program starting in July 1994, but it did not bill the DSS until February 1995. The billings to the DSS were late because the department did not have approved contracts with the DSS until December 1994. The department has taken corrective action to provide a timely contract for this grant effective for the fiscal year 1996-97.

Reimbursements Not Promptly Received

The department was not promptly reimbursed for services that it provided to the Los Angeles County Police Chief's Association (LACPCA) under the Drug Control and System Improvement grant. For example, the LACPCA paid a \$115,591 invoice in September 1995, that the department had submitted to LACPCA in April 1995. For other invoices that we reviewed, the length of time between the issuance of an invoice and receipt of payment averaged 83 days. Because of such delays, the State lost interest earnings of approximately \$7,000. Although the department bills the LACPCA timely and has attempted to resolve this concern, its contract with the LACPCA does not provide for prompt payment nor does it contain provisions for assessing interest on late payments.

Recommendations

To improve its administration of federal programs, the department should:

- Follow applicable federal requirements when determining costs for legal services provided under the Child Support Enforcement grant;
- Have employees certify attendance records for time worked and have appropriate administrative personnel approve the attendance records;
- Promptly bill the DSS for the costs of services chargeable to federal grants; and
- Amend its agreement with the LACPCA to provide prompt reimbursement for the costs of services chargeable to the federal grant. In addition, the amendment should provide for a reasonable rate of interest for payments not received within 30 days.

Appendix

U.S. Department of Justice and U.S. Department of Health and Human Services Grants

<u>Federal Catalog Number</u>	<u>Program Title</u>
16.579	Drug Control and System Improvement— Formula Grant
93.563	Child Support Enforcement

Federal and State Criteria

Allowable Costs

The Office of Management and Budget (OMB), Circular A-87, sets forth principles for determining the allowable costs of programs administered by the State under grants from the federal government. These cost principles are designed to ensure that federal financial assistance programs bear their fair share of costs recognized under the principles. The circular also defines the total cost of a grant program. Total costs consist primarily of allowable direct costs and pro rata share of any indirect costs. Direct costs are those that can be identified specifically with a grant. Typical direct costs include employee compensation and cost of acquired materials. Indirect costs are those that benefit more than one cost objective and are not readily assignable to a cost objective. The circular also states that, when services are provided by agencies other than the direct grantee, the cost of services provided may only include allowable direct costs of the service and a pro rata share of allowable indirect costs.

Attendance Records

The State Administrative Manual (SAM), Section 8539, requires that when attendance records are used they will be signed by both the employee and the employee's supervisor. Further, OMB Circular A-87 Revised, effective for fiscal year 1996-97, requires that attendance records must be signed by employees.

Timeliness of Billings

SAM Section 0911.4 requires state agencies to bill the federal government promptly.

State and Consumer Services

We reviewed the financial operations and related internal controls of the Franchise Tax Board (board).

Minor Issues of Noncompliance With State Requirements

We reviewed revenues and refunds in the Personal Income Tax Fund and the Bank and Corporate Tax Fund and noted the following instances of noncompliance with state requirements.

- The board did not always properly approve refunds to bank and corporation taxpayers. The board's procedures require that a manager approve refunds of \$50,000 or more. However, we tested a sample of 45 such refunds, totaling approximately \$16.4 million, and found the board made 3 refunds, totaling approximately \$900,000 without the manager's approval.
- Of the eight personal income tax penalties we tested, totaling approximately \$1 million, one penalty of \$113,000 assessed for the delinquent payment of taxes was undercalculated by \$1,524. In addition, the board did not always correctly calculate interest charged to banks and corporations for the underpayment of taxes. Specifically, of ten interest assessments we tested, totaling approximately \$5 million, one assessment for \$269,000 was overcalculated by \$1,450. In both cases, the assessments were reviewed, but the review failed to detect the error.

Recommendations

To improve its system of internal controls the board should:

- Ensure that all refunds of \$50,000 or more are properly approved before they are paid; and
- Improve its review of penalty and interest assessments to ensure they are calculated in accordance with the Revenue and Taxation Code.

Appendix

State Criteria

The Bank and Corporation Procedures Manual, page 6060-3, requires section managers to approve refunds of \$50,000 or more.

The California Revenue and Taxation Code, Section 19131, requires the board to assess a delinquent penalty when any taxpayer neglects to file a return on or before the due date of the return. The law requires a penalty of five percent per month, up to a maximum of 25 percent, to be multiplied by the unpaid tax for each month the return is delinquent due to a taxpayer's neglect.

The California Revenue and Taxation Code, Section 19521(a), establishes the interest rate the board charges certain corporations for the underpayment of taxes.

Department of General Services

We reviewed the financial operations and related internal controls of the Department of General Services (department).

Summary

- The department's Office of Machine Repair Services (OMRS) and Division of Telecommunications (Telecom) did not adequately control and account for inventory.
- The Telecom does not always comply with state administrative requirements related to procurement.
- The Office of State Printing (OSP) has a possible liability to the federal government.
- The OSP has inadequate controls over assets and does not always comply with state administrative requirements designed to safeguard state property.

The Department Did Not Adequately Control and Account for Inventory

State law requires departments to maintain an effective system of internal control, which includes procedures that provide for effective control over assets. However, the department's OMRS and Telecom did not adequately control and account for inventory.

The OMRS machine repair technicians routinely removed machine components from inventory and stored the components on their desks, in their vans, or at various other locations without maintaining a log or a list of inventory in their possession. When these items were removed from inventory, the OMRS inappropriately charged them to expense. As a result, the OMRS did not always know how much inventory was on hand or where it was located. Further, the OMRS's year-end inventory procedures were inadequate. It did not provide written instructions to employees for conducting the physical inventory count. Additionally, each machine repair technician was responsible for counting the inventory held in his own van.

Both the OMRS and Telecom did not appropriately account for inventory. For some inventory items, the OMRS inappropriately excluded sales tax and for other inventory items inappropriately included sales mark-up when calculating the value of year-end inventory. In addition, Telecom inappropriately included sales tax twice when calculating the value of year-end inventory. Further, the department reported in its financial statements the Telecom inventory value as of the physical inventory date rather than June 30. As a result of these errors, the department overstated the June 30, 1995, inventory balance in the financial statements submitted to the State Controller's Office by approximately \$269,000. In addition, because the OMRS inappropriately charged items stored in technicians' vans to expense when they were placed in the van even though they may not have been used to produce revenue until significantly later, the cost of goods sold may be misstated.

***The Department Did Not
Always Follow State Administrative
Requirements for Procurement***

The department's Telecom issued four separate delegation purchase orders totaling approximately \$48,400 to the same vendor, dated within the same week, for identical inventory items. By splitting the purchase into four different purchase orders, Telecom violated state administrative requirements requiring prior approval of the department's Procurement Division for purchase orders over \$15,000. Additionally, when it splits purchase orders, it may not ensure it receives the lowest price.

***The Office of State Printing Has
a Possible Liability to the
Federal Government***

As part of the printing services it provides to the State, the OSP prints a variety of legislative documents. Costs related to producing these documents are budgeted by the Legislature each fiscal year. However, when legislative printing costs exceed the funding provided by the Legislature, the additional cost is allocated among print jobs requested and paid for by state agencies. In fiscal years 1993-94 and 1994-95, the cost of legislative printing exceeded the funding provided by the Legislature by approximately \$299,000 and \$212,000, respectively. These costs are passed to state agencies through higher rates charged for printing services performed for those agencies. Because some state agencies pay for printing services with federal funds, a portion of these costs are paid with federal grant funds. This allocation violates the allowable cost provisions of the Office of Management and Budget Circular A-87. Circular A-87 specifically excludes general government and legislative expenses from the list of allowable federal program costs.

***The Office of State Printing Has
Inadequate Controls Over Assets***

The OSP does not maintain adequate control of its assets. Specifically, it could not locate paper stock valued at \$369,000. Additionally, the OSP failed to locate one of ten equipment items tested. In both instances, these assets were included in its accounting records, and the OSP had no record of having disposed of them. State law requires departments to maintain an effective system of internal control which includes recordkeeping procedures sufficient to provide effective accounting control over assets. In addition, the State Administrative Manual requires agencies to follow specific procedures when disposing of state property. Failure to comply with established controls increases the risk that state property may be stolen or misused.

Issue Reported in Prior Years

The following item was reported in previous years and due to its significance warrants corrective action by the department.

The Office of Public School Construction Does Not Promptly Audit Completed Projects

The Office of Public School Construction (OPSC) does not complete close-out audits of the school construction projects promptly. According to data provided by the OPSC, as of September 1995, approximately 723 school construction projects were ready for close-out audits. Of these, 174 have been ready for close-out audits for at least four years. Because it has not reviewed these projects, the OPSC has not yet determined the amount of allowable expenditures. Thus, it does not know whether the State owes districts additional funds or whether any funds that may have been apportioned to these projects in excess of actual costs should be returned to the State and made available for other projects. For example, OPSC completed 610 close-out audits between January 1992 and September 1995. These audits disclosed that certain school districts owed the State approximately \$14.7 million and the State owed other school districts approximately \$16.1 million of the districts' remaining apportioned amounts.

State law requires departments to maintain an effective system of internal control, which includes procedures that provide for effective control over assets, liabilities, revenues, and expenditures. Prompt close-out audits would enable the department to identify amounts available for other projects.

Other Instances of Noncompliance With State Requirements

In the following instances, the OPSC did not always maintain adequate controls over its accounting records for the State School Building Lease-Purchase Fund, fund 344:

- The OPSC did not properly analyze project balances to identify amounts due from school districts at June 30, 1995. As a result, the OPSC understated its due from other governments account balance at June 30, 1995, by approximately \$267,000.
- The OPSC did not reconcile its subsidiary project records with the amounts reflected on the budget report to ensure they agree. We noted errors in 9 of the 56 school construction projects we reviewed. The budget report was in error in four instances, the project records were in error in four instances, and both the budget report and the project record were in error in one instance. When the budget reports are in error, the account balances that the department reports to the SCO are incorrect. When project records are in error, the OPSC does not have accurate information readily available about the remaining funds for the projects before distributing funds to the school districts.

Recommendations

To safeguard its assets and improve its accounting and its system of internal controls, the department should:

- Require OMRS repair technicians to maintain a log of inventory removed from stock and reconcile the log to repair requests;
- Provide written instructions to all employees conducting the physical inventory;

- Ensure that machine repair technicians do not count inventory held in their own vans;
- Include only appropriate expenses when determining the cost of inventory;
- Ensure that property survey reports are prepared when equipment is disposed of;
- Ensure that completed school construction projects are audited promptly;
- Ensure that all amounts due from school districts are included in its financial statements; and
- Reconcile its subsidiary project records with its budget reports.

To ensure it receives the lowest price and purchases are proper, the department should consolidate purchase orders and obtain required approvals.

To improve compliance with federal grant requirements, the OSP should ensure that it does not allocate legislative or general government costs to state agencies that pay for printing services with federal grant funds.

Appendix

State Criteria

The California Government Code, Sections 13401 and 13403, requires agencies to maintain an effective system of internal control which includes recordkeeping procedures to provide effective accounting control over assets, liabilities, revenues, and expenditures.

The State Administrative Manual, Section 3572, requires state agencies to consolidate orders to obtain lower prices and prohibits state agencies from splitting delegation purchase orders for the purpose of circumventing expenditure limitations.

The State Administrative Manual, Section 8640, requires agencies to obtain proper approval from the Department of General Services, Property Reutilization, before disposing of state property.

The State Administrative Manual, Section 8640, requires agencies to prepare Property Survey Reports when they dispose of property.

The State Administrative Manual, Section 7900, states that properly prepared reconciliations represent an important element of internal control because they disclose errors in the agency accounts as they occur so that the accounts can then be corrected before the financial statements are prepared.

Accounting Criteria

Accounting Research Bulletin 43, Chapter 4, paragraph 5, states that the cost of inventory is the price paid to acquire the asset, including applicable expenses directly or indirectly incurred in bringing the inventory to its existing condition and location.

Federal Criteria

The Office of Management and Budget, Circular A-87, Attachment B, Section 23a.(1) and (2), specifically excludes the general costs of government, including legislative costs, from allowable federal program costs.

Youth and Adult Correctional

Department of Corrections

We reviewed the financial operations and related internal controls of the Department of Corrections (department).

The Department Incorrectly Accounted for Construction in Progress

The department incorrectly accounted for construction costs after projects were completed. Initially, projects in the construction phase should be accounted for as construction in progress in the General Fixed Asset Account Group. When the construction phase ends, the costs should be transferred from the construction in progress account to the building or improvements account. The department should delete completed projects from its construction in progress accounts and notify the various state correctional institutions to add the completed projects to their building accounts.

As of June 30, 1995, the department reported construction in progress totaling approximately \$546 million. We determined that \$506 million of the amount reported had been completed between 1991 and 1995. Further, the department's construction in progress account was overstated by \$498 million and the correctional institutions' building accounts were understated by \$498 million. Because the construction division and the accounting unit do not exchange information on the status of construction projects, the accounting unit has not made the entries necessary for the proper reporting of the completed projects.

As a result, construction costs of completed projects reported to the State Controller's Office for inclusion in the State's financial statements are misclassified. Further, a delay in transferring the costs from the construction in progress account to the building account delays the reporting of building additions to the Department of General Services for inclusion in the statewide real property inventory.

State administrative procedures state that the construction phase ends when a Notice of Completion is filed with the County Recorder, and that the completion date of any project should also be construed as being the date of final inspection or date of occupancy of the project, whichever is earliest.

Recommendations

To improve its accounting for construction in progress, the department should:

- Direct the construction division to inform the accounting unit of the status of construction projects at the end of the fiscal year.
- Transfer the costs of completed construction projects from the construction in progress account to the various correctional institutions and ensure that the institutions record the completed projects in their building accounts at the end of the fiscal year.

Appendix

State Criteria

Accounting for Construction in Progress

The State Administrative Manual, Section 8600 et seq., defines property, including buildings, and outlines the requirements for property reporting. Further, Section 6561 states that the construction phase ends when a Notice of Completion is filed with the County Recorder, and Section 6750 states that the completion date should also be construed as being the date of final inspection or date of occupancy of the project, whichever is earliest.

Department of the Youth Authority

We reviewed the financial operations and related internal controls of the Department of the Youth Authority (department) and the department's administration of the U.S. Department of Agriculture grants, Federal Catalog Nos. 10.553 and 10.555.

Inadequate Documentation of Meals Claimed for Reimbursement

Under provisions of the School Breakfast (SB) and National School Lunch (NSL) federal programs, the department claims reimbursement for meals served to eligible wards at state institutions that house youthful offenders. We reviewed all of the department's monthly claims for federal reimbursement for fiscal year 1994-95. The department operates the SB and NSL programs at all 15 of its institutions. At 3 institutions, we tested the supporting detail of the monthly claims. At one of the 3 institutions, we found that the supporting detail for eight months of fiscal year 1994-95 was missing. For those eight months, the department claimed approximately \$611,600 in reimbursements for 194,816 breakfasts and 216,952 lunches. Without the required supporting detail for the monthly claims, we are unable to determine that the claimed meals were served to eligible recipients. When we asked the food service manager at the school about the missing documentation, he told us that he misunderstood the directions from the department's headquarters and thought the retention of the supporting detail was not required. When he realized his error, he began saving the supporting detail.

At a second institution, we found that the department underclaimed its reimbursements by approximately \$5,700 for eligible meals served. The underclaimed reimbursements were due to three clerical errors that the institution made on its claims for reimbursement for the months of August and November 1994, and March 1995. These clerical errors were not discovered during the department's internal review of the claims.

Recommendation

To improve its administration of its SB and NSL programs, the department should:

- Review all claims for reimbursement to ensure that the claims are accurate and have the required supporting detail.

Appendix

U. S. Department of Agriculture Grants

<u>Federal Catalog Number</u>	<u>Program Title</u>
10.553	School Breakfast Program
10.555	National School Lunch Program

Federal Criteria

The Code of Federal Regulations, Title 7, Subpart B, Sections 210.2, 220.2, 210.6, and 220.6, provides that to be entitled to reimbursement for meals under the SB and SL programs, claims must (1) be supported by accurate meal counts and records and (2) served to eligible children.

Report on Compliance With Federal Grant Requirements

Independent Auditor's Report on Compliance With Federal Grant Requirements

The Governor and Legislature of
the State of California

We have audited the general purpose financial statements of the State of California as of and for the year ended June 30, 1995, and have issued our report thereon dated December 15, 1995. The California State University's compliance with federal requirements was audited by another independent auditor whose report has been furnished to us, and our opinion, insofar as it relates to the California State University is based solely upon the report of the other independent auditor. The scope of our audit did not extend to financial aid programs administered by the University of California because they contract with other independent certified public accountants for Office of Management and Budget (OMB) Circular A-133 audits. In addition, our audit of charges made by subrecipients of federal funds was limited to a review of the State's system for monitoring those subrecipients because subrecipients have OMB Circular A-128 audits or OMB Circular A-133 audits performed by other independent auditors.

The following sections provide our opinion on major federal programs, our report on general requirements for major federal programs, and our report on nonmajor federal programs.

Major Programs

We have also audited the State of California's compliance with the requirements governing types of services allowed or not allowed; eligibility; matching, level of effort, or earmarking of funds; reporting; special tests and provisions; federal financial reports and claims for advances and reimbursements; and amounts claimed or used for matching that are applicable to each of its major federal financial assistance programs. The major federal financial assistance programs for the year ended June 30, 1995, are identified in the schedule of federal assistance beginning on page 227. The State's management is responsible for the State's compliance with these requirements. Our responsibility is to express an opinion on compliance with these requirements based on our audit.

We conducted our audit of compliance with these requirements in accordance with generally accepted auditing standards, *Government Auditing Standards*, issued by the Comptroller of the United States, and OMB Circular A-128, *Audits of State and Local Governments*. Those standards and OMB Circular A-128 require that we plan and perform the audit to obtain reasonable assurance about whether material noncompliance with the requirements referred to above occurred. An audit includes examining, on a test basis, evidence about the State of California's compliance with those requirements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the State of California complied, in all material respects, with the requirements governing types of services allowed or unallowed; eligibility; matching, level of effort, or earmarking of funds; reporting; special tests and provisions that are applicable; federal financial

reports and claims for advances and reimbursements; and amounts claimed or used for matching that are applicable to each of its major federal financial assistance programs for the year ended June 30, 1995.

Further, we have applied procedures to test the State of California's compliance with the following general requirements applicable to each of its major federal financial assistance programs, which are identified in the schedule of federal financial assistance beginning on page 227, for the year ended June 30, 1995: political activity, Davis Bacon Act, civil rights, cash management, relocation assistance and real property acquisition, federal financial reports, allowable costs/cost principles, Drug-Free Workplace Act, and administrative requirements. Our procedures for testing compliance with these requirements were limited to the applicable procedures described in the OMB's *Compliance Supplement for Single Audits of State and Local Governments*. Our procedures were substantially less in scope than an audit, the objective of which is the expression of an opinion on the State of California's compliance with requirements listed in the preceding paragraph. Accordingly, we do not express such an opinion on the general requirements.

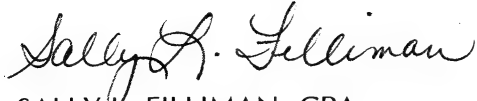
Nonmajor Programs

In connection with our audit of the State of California's general purpose financial statements and with our consideration of the State's control structure used to administer federal financial assistance programs, as required by OMB Circular A-128, we selected certain transactions applicable to certain nonmajor federal financial assistance programs for the year ended June 30, 1995. As required by OMB Circular A-128, we have performed auditing procedures to test compliance with the requirements governing types of services allowed, eligibility, and special tests and provisions that are applicable to those transactions. Our procedures were substantially less in scope than an audit, the objective of which is the expression of an opinion on the State's compliance with these requirements. Accordingly, we do not express such an opinion on the nonmajor programs.

With respect to all the items tested, the results of the procedures described above disclosed no material instances of noncompliance with the requirements identified in the preceding paragraphs. With respect to the items not tested, nothing came to our attention that caused us to believe that the State of California had not complied, in all material respects, with those requirements. However, the results of our audit procedures disclosed immaterial instances of noncompliance with those requirements. We discuss those instances of noncompliance and present recommendations to correct them in the section of our report beginning on page 35. The instances of noncompliance identified in the State's single audit report for fiscal year 1993-94 that have not been corrected are also included in that section. Additionally, beginning on page 264, we present a schedule listing instances of noncompliance that we consider to be minor. We considered these instances of noncompliance in forming our opinion on compliance with requirements for major federal programs, which is expressed above.

This report is intended for the information of the Governor and Legislature of the State of California and the management of the executive branch. However, this report is a matter of public record, and its distribution is not limited.

BUREAU OF STATE AUDITS

A handwritten signature in cursive script, reading "Sally L. Filliman".

SALLY L. FILLIMAN, CPA
Deputy State Auditor

April 15, 1996

**Report on the
Schedule of Federal Assistance**

Independent Auditor's Report on the Schedule of Federal Assistance

The Governor and Legislature of
the State of California

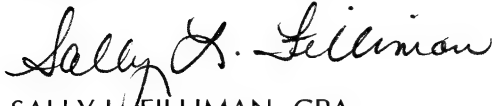
We have audited the general purpose financial statements of the State of California as of and for the year ended June 30, 1995, and have issued our report thereon dated December 15, 1995. These general purpose financial statements are the responsibility of management of the State of California. Our responsibility is to express an opinion on these general purpose financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the general purpose financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Our audit was made for the purpose of forming an opinion on the general purpose financial statements of the State of California, taken as a whole. The accompanying schedule of federal assistance is presented for purposes of additional analysis and is not a required part of the general purpose financial statements. The Office of Management and Budget, Circular A-128, *Audits of State and Local Governments*, and the Single Audit Act of 1984 require the schedule of federal assistance to present total expenditures for each federal assistance program. However, although the state accounting system separately identifies revenues for each federal assistance program, it does not separately identify expenditures for each program. As a result, the State presents the schedule of federal assistance on a revenue basis. The schedule shows the amount of federal funds and the estimated value of food stamps and commodities received by the State for the year ended June 30, 1995. The information in that schedule has been subjected to the auditing procedures applied in the audit of the general purpose financial statements and, in our opinion, is fairly presented in all material respects in relation to the general purpose financial statements taken as a whole. The schedule also includes revenue for financial aid received by the California State University. These revenues were audited by other independent auditors, and our opinion, insofar as it relates to the California State University revenues, is based solely on the report provided by these auditors. The schedule does not include federal revenue received by the University of California. These revenues are audited by other independent auditors in accordance with the Office of Management and Budget, Circular A-133, *Audits of Institutions of Higher Education and Other Nonprofit Organizations*.

This report is intended for the information of the Governor and Legislature of the State of California and the management of the executive branch. However, this report is a matter of public record, and its distribution is not limited.

BUREAU OF STATE AUDITS

A handwritten signature in black ink, reading "Sally L. Filliman". The signature is written in a cursive, flowing style.

SALLY L. FILLIMAN, CPA
Deputy State Auditor

April 15, 1996

**Schedule of Federal Assistance for
Fiscal Year Ended June 30, 1995**

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Department of Agriculture:		
Agricultural Conservation Program	10.063	\$ 3,621
Agricultural and Rural Economic Research	10.250	32,159 C
Farm Labor Housing Loans and Grants	10.405	160,000
Food Distribution	10.550	78,408,676 A
Food Stamps	10.551	2,576,685,479 A * O
School Breakfast Program	10.553	142,215,697 A
National School Lunch Program	10.555	580,549,017 A
Special Milk Program for Children	10.556	881,772
Special Supplemental Food Program for Women, Infants, and Children	10.557	502,623,691 A
Child and Adult Care Food Program	10.558	168,334,647 A *
Summer Food Service Program for Children	10.559	211,250 **
State Administrative Expenses for Child Nutrition	10.560	12,448,766
State Administrative Matching Grants for Food Stamp Program	10.561	275,704,386 A
Nutrition Education and Training Program	10.564	898,674
Commodity Supplemental Food Program	10.565	5,532,042 **
Emergency Food Assistance Program (Administrative Costs)	10.568	9,091,652
Nutrition Program for the Elderly	10.570	13,159,296
Food Commodities for Soup Kitchens	10.571	5,192,490

The accompanying notes are an integral part of this schedule.
Endnotes appear on page 250.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Forestry Research	10.652	73,097 C
Cooperative Forestry Assistance	10.664	966,502 O
Schools and Roads—Grants to States	10.665	50,981,328 A
National Forest—Dependent Rural Communities	10.670	98,662
Other—U.S. Department of Agriculture	10.999	3,891,058

Department of Commerce:

Trade Development	11.110	250,409
Economic Development—Support for Planning Organizations	11.302	42,240
Economic Development—Technical Assistance	11.303	46,728
Economic Development—State and Local Economic Development Planning	11.305	100,000
Special Economic Development and Adjustment Assistance Program— Sudden and Severe Economic Dislocation and Long-Term Economic Deterioration	11.307	333,321
Anadromous Fish Conservation Act Program	11.405	297,685
Coastal Zone Management Administration Awards	11.419	2,924,632
Coastal Zone Management Estuarine Research Reserves	11.420	219,447
Financial Assistance for Ocean Resources Conservation and Assessment Program	11.426	224,885
Marine Sanctuary Program	11.429	65,913
Public Telecommunications Facilities—Planning and Construction	11.550	548

The accompanying notes are an integral part of this schedule.
Endnotes appear on page 250.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Manufacturing Extension Partnership	11.611	2,931,831
Other—U.S. Department of Commerce	11.999	83,130
Department of Defense:		
Navigation Projects	12.107	18,353 8,138 C
Planning Assistance to States	12.110	227,771 11,896 C
State Memorandum of Agreement Program for the Reimbursement of Technical Services	12.113	11,165,742
Community Economic Adjustment Planning Assistance	12.607	151,648
Selected Reserve Educational Assistance Program	12.609	472,569 C
Language Grant Program	12.900	87,623 75,285 C
Mathematical Sciences Grants Program	12.901	36,629 63,555 C
Research and Technology Development	12.910	2,000,000
Other—U.S. Department of Defense	12.999	10,149,642
Department of Housing and Urban Development:		
Community Development Block Grants—State's Program	14.228	32,570,098 A
Emergency Shelter Grants Program	14.231	3,020,366
Supportive Housing Program	14.235	1,706,352
Home Investment Partnerships Programs	14.239	29,355,164 A

The accompanying notes are an integral part of this schedule.
Endnotes appear on page 250.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Housing Opportunities for Persons with AIDS	14.241	2,189,400
Equal Opportunity in Housing	14.400	1,006,000
Section 8 Rental Voucher Program	14.855	995,534
Lower Income Housing Assistance Program— Section 8 Moderate Rehabilitation	14.856	343,362
Section 8 Rental Certificate Program	14.857	2,355,959
Lead-Based Paint Hazard Control Program	14.900	2,358,367
Department of Interior:		
Endangered Honeycreeper on Maui	15.162	898,397 C
Small Reclamation Projects	15.503	275,897
Sport Fish Restoration	15.605	9,168,359
Fish and Wildlife Management Assistance	15.608	6,574 C
Wildlife Restoration	15.611	6,472,406
Endangered Species Conservation	15.612	711,951 42,004 C
Wildlife Conservation and Appreciation	15.617	5,006 C
Geological Survey—Research and Data Acquisition	15.808	87,786 27,966 C
Historic Preservation Fund Grants-In-Aid	15.904	1,617,552
Outdoor Recreation—Acquisition, Development and Planning	15.916	1,557,158
Research Information	15.975	1,413,328

The accompanying notes are an integral part of this schedule.
Endnotes appear on page 250.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Other—U.S. Department of Interior	15.999	7,683,716 36,892 C
Shared Revenue—Potash/Sodium Lease	15.999	22,772,483 A

Department of Justice:

Juvenile Justice and Delinquency Prevention— Allocation to States	16.540	6,971,614 70,667 C
Missing Children's Assistance	16.543	31,448
Criminal Justice Statistics Development	16.550	215,962
Justice Research, Development and Evaluation Project Grants	16.560	365,241
Criminal Justice Discretionary Grant Program	16.574	7,146,228
Crime Victim Assistance	16.575	7,158,518
Crime Victim Compensation	16.576	17,863,000
Drug Control and System Improvement— Formula Grant	16.579	44,851,173 A
Corrections—Technical Assistance/Clearinghouse	16.603	199,211
Other—U.S. Department of Justice	16.999	1,544,314

Department of Labor:

Labor Force Statistics	17.002	5,672,317
Labor Certification for Alien Workers	17.203	11,736,320
Employment Service	17.207	118,889,748 A
Unemployment Insurance	17.225	415,138,115 A

The accompanying notes are an integral part of this schedule.
Endnotes appear on page 250.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received	
Senior Community Service Employment Program	17.235	6,860,945	
Trade Adjustment Assistance—Workers	17.245	26,167,207	A O
Employment and Training Assistance—Dislocated Workers	17.246	169,388,468	A
Migrant and Seasonal Farmworkers	17.247	2,577,197	
Employment Services and Job Training—Pilot and Demonstration Programs	17.249	240,560	
Job Training Partnership Act	17.250	387,375,055	A
Occupational Safety and Health	17.504 (17.500)	20,544,736	A ***
Mine Health and Safety Grants	17.600	197,125	
Women's Special Employment Assistance	17.700	215,587	
Disabled Veterans Outreach Program	17.801	11,732,371	
Veterans' Employment Program	17.802	831,983	
Local Veterans' Employment Representative Program	17.804	6,908,000	
Department of Transportation:			
Boating Safety Financial Assistance	20.005	976,680	
Aviation Education	20.100	4,646	C
Airport Improvement Program	20.106	175,399	
Highway Planning and Construction	20.205	1,642,787,769	A
Motor Carrier Safety	20.217	3,656,638	
Motor Carrier Safety Assistance Program	20.218	38,544	

The accompanying notes are an integral part of this schedule.
Endnotes appear on page 250.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Railroad Safety	20.301	2,931
Federal Transit Capital Improvement Grants	20.500	6,739,083
Federal Transit Technical Studies Grants	20.505	8,125,937
Public Transportation for Nonurbanized Areas	20.509	5,112,009
State and Community Highway Safety	20.600	25,145,260 A
Pipeline Safety	20.700	613,319
Interagency Hazardous Materials Public Sector Training and Planning Grants	20.703	245,632
State Marine Schools	20.806	200,000
Other—U.S. Department of Transportation	20.999	284,838
Department of Treasury:		
Other—U.S. Department of Treasury	21.999	89,499
Equal Employment Opportunity Commission:		
Employment Discrimination—State and Local Fair Employment Practices Agency Contracts	30.002	3,227,150
General Services Administration:		
Donation of Federal Surplus Personal Property	39.003	12,756,720 O **
National Aeronautics and Space Administration:		
Aerospace Education Services Program	43.001	403,650 C
Technology Transfer	43.002	30,856 C

The accompanying notes are an integral part of this schedule.
Endnotes appear on page 250.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
National Foundation on the Arts and the Humanities:		
Promotion of the Arts—Art In Education	45.003	100,990
Promotion of the Arts—Media Arts: Film/Radio/Television	45.006	61,880 C
Promotion of the Arts—State and Regional Program	45.007	916,586
Promotion of the Arts—Theater	45.008	77,513 C
Promotion of the Arts—Local Arts Agencies Program	45.023	225,650
National Science Foundation:		
Engineering Grants	47.041	19,606 C
Mathematical and Physical Sciences	47.049	514,734 19,324 C
Geosciences	47.050	59,721 C
Scientific Technological Affairs	47.053	7,507 C 158,797 C
Education and Human Resources	47.066	82,442 C
Material Development and Information	47.067	133,418 C
Studies, Evaluation and Dissemination	47.068	838,200 C
Computer and Information Science and Engineering	47.070	55,232 C
Science and Technology Centers	47.073	430,280 C
Biological Sciences	47.074	77,681 C
Social, Behavioral, and Economic Sciences	47.075	20,351
Education and Human Resources	47.076	739,526 262,271 C

The accompanying notes are an integral part of this schedule.
Endnotes appear on page 250.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Academic Research Facilities and Instrumentation	47.077	21,348 C
Small Business Administration:		
Business Development Assistance to Small Business	59.005	32,069 C
Procurement Assistance to Small Businesses	59.009	2,031,162
Small Business Development Center	59.037	4,854,228
Department of Veterans Affairs:		
Grants to States for Construction of State Home Facilities	64.005	14,915,513
Veterans State Domiciliary Care	64.014	3,092,268
Veterans State Nursing Home Care	64.015	5,235,658
Veterans State Hospital Care	64.016	141,763
All-Volunteer Force Educational Assistance	64.124	48,704
Other—U.S. Department of Veterans Affairs	64.999	1,026,174
Environmental Protection Agency:		
Air Pollution Training Program	66.000	28,964 C
Air Pollution Control Program Support	66.001	17,623,741
Air Pollution Control—Technical Training	66.006	71,450
Air Pollution Control—National Ambient Air and Source Emission Data	66.007	152,717
State Indoor Radon Grants	66.032	154,737
Construction Grants for Wastewater Treatment Works	66.418	185,945

The accompanying notes are an integral part of this schedule.
Endnotes appear on page 250.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Water Pollution Control—State and Interstate Program Support	66.419	4,901,843
State Underground Water Source Protection	66.433	404,624
Water Pollution Control—Lake Restoration Cooperative Agreements	66.435	283,604
Water Quality Management Planning	66.454	1,215,845
National Estuary Program	66.456	997,725 1,653 C
Capitalization Grants for State Revolving Funds	66.458	105,208,787 A
Nonpoint Source Implementation Grants	66.460	6,914,384
Wetlands Protection—State Development Grants	66.461	542,471
EPA New Coastal Waters Program	66.462	192,665
National Pollutant Discharge Elimination System Related State Program Grants	66.463	351,301
Near Coastal Waters	66.464	157,531
Solid Waste Disposal Research	66.504	108,309
Water Pollution Control—Research, Development, and Demonstration	66.505	127,481
Safe Drinking Water Research and Demonstration	66.506	5,629,802
Consolidated Pesticide Compliance Monitoring and Program Cooperative Agreements	66.700	1,426,872
Toxic Substances Compliance Monitoring Cooperative Agreements	66.701	32,199
Pollution Prevention Grants Program	66.708	94,292

The accompanying notes are an integral part of this schedule.
Endnotes appear on page 250.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Hazardous Waste Management State Program Support	66.801	12,088,941 17,538 C
Superfund State Site-Specific Cooperative Agreements	66.802	5,016,067
Leaking Underground Storage Tank Trust Fund Program	66.805	5,564,059
Other—U. S. Environmental Protection Agency	66.999	367,073

Department of Energy:

State Energy Conservation	81.041	1,407,782
Weatherization Assistance for Low-Income Persons	81.042	5,131,641
Basic Energy Sciences—University and Science Education	81.049	183,483 C
Energy Extension Service	81.050	348,874
Energy Conservation for Institutional Buildings	81.052	716,165
Regional Biomass Energy Programs	81.079	47,391
Office of Policy and Financial Assistance	81.080	27,824 C
Environmental Restoration	81.092	1,794,464
Science and Engineering Research Semester	81.097	2,224

United States Information—Agency:

Educational Exchange—University Lecturers (Professors) and Research Scholars	82.002	215,237 C
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Federal Emergency Management Agency:

Acquisition of Flood Damaged Structures	83.104	219,358
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The accompanying notes are an integral part of this schedule.
Endnotes appear on page 250.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Civil Defense—State and Local Emergency Management Assistance	83.503	5,520,125
Disaster Assistance	83.516	1,021,018,083 A
Earthquake Hazards Reduction Grants	83.521	1,689,065
National Urban Search and Rescue (US&R) Response System	83.526	280,376
Emergency Management Institute—Field Training Program	83.528	748,779
State and Local Emergency Management Assistance—Other Assistance	83.531	473,477
Facilities and Equipment	83.532	66,272
Other—Federal Emergency Management Agency	83.999	12,869

Department of Education:

Adult Education—State Administered Basic Grant Program	84.002	24,618,520 A
Desegregation Assistance, Civil Rights Training, and Advisory Services	84.004	446,500
Federal Supplemental Educational Opportunity Grants	84.007	44,543 11,674,328 C
Education of Children with Disabilities in State Operated or Supported Schools	84.009	1,682,237
Title I Grants to Local Educational Agencies	84.010	693,015,234 A
Migrant Education—Basic State Grant Program	84.011	82,680,431 A
Educationally Deprived Children—State Administration	84.012	6,132,163

The accompanying notes are an integral part of this schedule.
Endnotes appear on page 250.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Title I Program for Neglected and Delinquent Children	84.013	4,170,731
Special Education—Innovation and Development	84.023	212,435 C
Services for Children with Deaf—Blindness	84.025	632,272 238,778 C
Special Education—Grants to States	84.027	212,266,746 A
Special Education—Personnel Development and Parent Training	84.029	284,419 837,001 C
Federal Family Education Loans	84.032	269,735,965 A 379,249,186 B
Federal Work-Study Program	84.033	91,461 9,642,507 C
Public Library Services	84.034	8,483,773
Interlibrary Cooperation and Resource Sharing	84.035	2,270,721
Federal Perkins Loan Program—Federal Capital Contributions	84.038	6,607 14,839,877 C
Training in Early Childhood Education and Violence Counseling Student Support Services	84.042	167,014 C
Vocational Education—Basic Grants to States	84.048	108,352,534 A
Vocational Education—Consumer and Homemaking Education	84.049	3,574,505
Vocational Education— State Councils	84.053	621,363
Higher Education—Cooperative Education	84.055	185,822 C
Federal Pell Grant Program	84.063	101,813 130,296,513 B
State Student Incentives Grants	84.069	11,124,348

The accompanying notes are an integral part of this schedule.
Endnotes appear on page 250.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Special Education—Postsecondary Education Programs for Persons with Disabilities	84.078	39,650 C
Special Education—Program for Severely Disabled Children	84.086	142,366
Fund for the Improvement of Postsecondary Education	84.116	45,029 C
Rehabilitation Services—Vocational Rehabilitation Grants to States	84.126	222,151,680 A O
Rehabilitation Services—Service Projects	84.128	1,812,059
Rehabilitation Long-Term Training	84.129	376,926 C
Centers for Independent Living	84.132	818,054
National Institute on Disability and Rehabilitation Research	84.133	14,943 C
Migrant Education—Coordination Program	84.144	33,270
Chapter 2—State Block Grants	84.151	43,367,222 A
Public Library Construction and Technology Enhancement	84.154	2,270,178
Secondary Education and Transitional Services for Youth with Disabilities	84.158	277,437
Immigrant Education	84.162	7,558,548
Eisenhower Mathematics and Science Education—State Grants	84.164	27,090,723 A
Eisenhower Professional Development—Federal Activities	84.168	201,724
Independent Living—State Grants	84.169	976,152
Special Education—Preschool Grants	84.173	27,370,295 A
Vocational Education—Community Based Organizations	84.174	1,488,325

The accompanying notes are an integral part of this schedule.
Endnotes appear on page 250.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Douglas Teacher Scholarships	84.176	1,696,490
Special Education—Grants for Infants and Families with Disabilities	84.181	24,128,588 A
Drug-Free Schools and Communities—National Programs	84.184	21,855 C
Byrd Honors Scholarships	84.185	1,451,175 4,500 C
Safe and Drug-Free Schools—State Grants	84.186	56,366,664 A
Supported Employment Services for Individuals with Severe Disabilities	84.187	4,796,705
Christa McAuliffe Fellowships	84.190	219,972
Adult Education—Literacy Training for Homeless Adults	84.192	639,290
Bilingual Education Support Services	84.194	1,813,150
Education for Homeless Children and Youth	84.196	1,785,785
College Library Technology and Cooperation Grants	84.197	3,690
Graduate Assistance in Areas of National Need	84.200	178,212 C
Women and Minority Participation in Graduate Education	84.202	105,774 C
Even Start—State Educational Agencies	84.213	8,263,037
Even Start—Migrant Education	84.214	136,943
Fund for the Improvement of Education	84.215	600
Capital Expenses	84.216	2,526,503
State Program Improvement Grants	84.218	2,635,491

The accompanying notes are an integral part of this schedule.
Endnotes appear on page 250.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Student Literacy Corps and Student Mentoring Corps	84.219	1,130,783
State Grants for Assistive Technology	84.224	681,455
National Science Scholars	84.242	4,131 C
Tech-Prep Education	84.243	14,408,248
Rehabilitation Short-Term Training	84.246	49,065 C
Foreign Languages Assistance	84.249	711,534
State Literacy Resource Centers	84.254	824,419
Rehabilitation Training—State Vocational Rehabilitation Unit In-Service	84.265	191,651
Training in Early Childhood Education and Violence Counseling	84.266	343,226 C
State Postsecondary Review	84.267	458,289
National Early Intervention Scholarship and Partnership	84.272	300,001
Demonstration Grants for Critical Language and Area Studies	84.273	98,031 C
Goals 2000—State and Local Education Systemic Improvement Grants	84.276	1,045,216

Consumer Product Safety Commission:

Other—Consumer Product Safety Commission	87.999	11,840
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Department of Health and Human Services:

Public Health and Social Services Emergency Fund	93.003	10,758,000
Special Programs for the Aging—Title VII, Chapter 3—Programs for Prevention of Elder Abuse, Neglect and Exploitation	93.041	491,193

The accompanying notes are an integral part of this schedule.
Endnotes appear on page 250.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Special Programs for the Aging—Title VII, Chapter 2—Long-Term Care Ombudsman Services for Older Individuals	93.042	426,401
Special Programs for the Aging—Title III, Part F—Disease Prevention and Health Promotion Services	93.043	2,760,975
Special Programs for the Aging—Title III, Part B—Grants for Supportive Services and Senior Centers	93.044	29,238,781 A
Special Programs for the Aging—Title II , Part C—Nutrition Services	93.045	42,682,536 A
Special Programs for the Aging—Title III, Part D—In Home Services for Frail Older Individuals	93.046	788,943
Special Programs for the Aging—Title IV—Training, Research and Discretionary Projects and Programs	93.048	3,499,349
Special Programs for the Aging—Title VII, Chapter 6—Allotments for Vulnerable Elder Rights Protection Programs	93.049	26,844
Special Programs for the Aging—Title II—Preconference Programs for the White House Conference on Aging	93.050	44,239
Field-Initiated Small Grants in Minority Health	93.100	12,096 C
Grants for Residential Treatment Programs for Pregnant and Postpartum Women	93.101	4,784,534
Demonstration Grants for Residential Treatment for Women and Their Children	93.102	1,225,531
Food and Drug Administration—Research	93.103	326,949
Comprehensive Community Mental Health Services for Children with Serious Emotional Disturbances	93.104	580,922
Maternal and Child Health Federal Consolidated Programs	93.110	75,500

The accompanying notes are an integral part of this schedule.
Endnotes appear on page 250.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Biological Response to Environmental Health Hazards	93.113	38,025 C
Project Grants and Cooperative Agreements for Tuberculosis Control Programs	93.116	5,426,850
Acquired Immunodeficiency Syndrome (AIDS) Activity	93.118	9,182,074
Mental Health Planning and Demonstration Projects	93.125	786,292
Emergency Medical Services for Children	93.127	154,751
Grants for Technical Assistance Activities Related to the Block Grant for Community Mental Health Services—Mental Health Statistics Improvement Program	93.128	79,384
Injury Prevention and Control Research and State Grants Projects	93.136	207,400
Minority Community Health Coalition Demonstration	93.137	271,723 C
Projects for Assistance in Transition from Homelessness (PATH)	93.150	3,518,064
Health Program for Toxic Substances and Disease Registry	93.161	529,114
Grants for State Loan Repayment	93.165	617,151
Community Youth Activity Program Demonstration Grants	93.170	117,314
Community Youth Activity Program Block Grants	93.171	159,268 C
Disabilities Prevention	93.184	290,838
Cooperative Agreements for Drug Abuse Treatment Improvement Projects in Target Cities	93.196	4,011,038 90,740 C
Biological Models and Materials Research	93.198	32,249 C

The accompanying notes are an integral part of this schedule.
Endnotes appear on page 250.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Health Services Research and Development Grants	93.226	239,344 C
Mental Health Research Grants	93.242	468,678
Childhood Immunization Grants	93.268	15,707,447
Centers for Disease Control and Prevention— Investigations and Technical Assistance	93.283	1,564,157
General Clinical Research Centers	93.333	73,023 C
Biomedical Research Support	93.337	165,140 C
Professional Nurse Traineeships	93.358	30,778 C 233,348 C
Nursing Student Loans	93.364	54,992 C
Academic Research Enhancement Award	93.390	8,610 C
Cancer Detection and Diagnosis Research	93.394	287 C
Emergency Protection Grants—Substance Abuse	93.554	45,158
Family Preservation and Support Services	93.556	3,552,459
Family Support Payments to States—Assistance Payments	93.560	3,507,942,946 A O
Job Opportunities and Basic Skills Training	93.561	141,274,065 A
Assistance Payments—Research	93.562	90,518
Child Support Enforcement	93.563	242,208,709 A 83,302 C
State Legalization Impact Assistance Grants	93.565	171,394,482 A
Refugee and Entrant Assistance—State Administered Programs	93.566	87,285,118 A O
Low-Income Home Energy Assistance	93.568	70,700,697 A
Community Services Block Grant	93.569	35,579,690 A

The accompanying notes are an integral part of this schedule.
Endnotes appear on page 250.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Community Services Block Grant Discretionary Awards—Community Food and Nutrition	93.571	538,368
Emergency Community Services for the Homeless	93.572	2,083,773
Child Care for Families At-Risk of Welfare Dependency	93.574	75,389,573 A
Payments to States for Child Care Assistance	93.575	116,919,899 A O
Refugee and Entrant Assistance-Discretionary Grants	93.576	728,651 31,526 C
U.S. Repatriate Program	93.579	19,963
Refugee and Entrant Assistance—Targeted Assistance	93.584	6,094,445
Head Start	93.600	90,537
Developmental Disabilities Basic Support and Advocacy Grants	93.630	6,214,233
Children’s Justice Grants to States	93.643	766,563
Child Welfare Services—State Grants	93.645	31,996,342 A
Social Services Research and Demonstration	93.647	88,925
Adoption Opportunities	93.652	4,306
Temporary Child Care and Crisis Nurseries	93.656	749,408
Foster Care—Title IV-E	93.658	556,479,446 A O
Adoption Assistance	93.659	40,881,281 A
Social Services Block Grant	93.667	367,443,481 A
Child Abuse and Neglect State Grants	93.669	2,350,167
Child Abuse and Neglect Discretionary Activities	93.670	359,588
Family Violence Prevention and Services—Grants to States and Indian Tribes	93.671	1,993,605

The accompanying notes are an integral part of this schedule.
Endnotes appear on page 250.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received	
Community-Based Prevention Program	93.672	915,493	
Grants to States for Planning and Development of Dependent Care Programs	93.673	1,294,867	
Independent Living	93.674	10,549,726	
Medicare—Hospital Insurance	93.773	1,122,187	
Medicare—Supplementary Medical Insurance	93.774	11,672,637	
State Medicaid Fraud Control Units	93.775	7,792,907	
State Survey and Certification of Health Care Providers and Suppliers	93.777	21,844,785	A O
Medical Assistance Program	93.778	8,626,191,006	A O
Health Care Financing Research, Demonstrations and Evaluations	93.779	748,992	
Cell Biology and Biophysics Research	93.821	34,881	C
Cellular and Molecular Basis of Disease Research	93.859 (93.863)	139,149	C ***
Aging Research	93.866	12,104	C
Model Comprehensive Drug Abuse Treatment Programs for Critical Populations	93.902	8,295,433	
Model Criminal Justice Drug Abuse Treatment for Incarcerated Populations, Nonincarcerated Populations, and Juvenile Justice Populations	93.903	4,406,489	
Grants to States for Operation of Offices of Rural Health	93.913	777,807	
HIV Care Formula Grants	93.917	21,170,524	A
Cooperative Agreements for State-Based Comprehensive Breast and Cervical Cancer Early Detection Programs	93.919	4,661,429	

The accompanying notes are an integral part of this schedule.
Endnotes appear on page 250.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
Scholarships for Health Professions Students from Disadvantaged Backgrounds	93.925	80,648 C
Demonstration Grants to States for Community Scholarships	93.931	23,717
Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems	93.938	581,215
HIV Demonstration Research and Education	93.941	1,161 C
Assistance Program for Chronic Disease Prevention and Control	93.945	44,910
HIV/AIDS and Related Diseases Among Substance Abusers: Community-Based Outreach and Intervention Demonstration Programs	93.949	1,380,148
Demonstration Grants to States with Respect to Alzheimer's Disease	93.951	566,195
Block Grants for Community Mental Health Services	93.958	36,480,851 A
Block Grants for Prevention and Treatment of Substance Abuse	93.959	152,575,415 A
Preventive Health Services—Sexually Transmitted Diseases Control Grants	93.977	2,310,853
Mental Health Disaster Assistance and Emergency Mental Health	93.982	20,046,318 A
Health Programs for Refugees	93.987	540,350
Cooperative Agreements for State-Based Diabetes Control Programs and Evaluation of Surveillance Systems	93.988	181,602
National Health Promotion	93.990	50,684
Preventive Health and Health Services Block Grant	93.991	10,419,165

The accompanying notes are an integral part of this schedule.
Endnotes appear on page 250.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received	
Maternal and Child Health Services Block Grant to the States	93.994	45,230,010	A
Other—Department of Health and Human Services	93.999	7,097,815	
Corporation for National and Community Service:			
Service America/Higher Education	94.001	1,926,904	
State Commission	94.003	798,859	
Community Service Learning	94.005	27,302	C
Americorps	94.006	6,025,778	
Summer of Safety Youth Corps	94.008	65,043	
Foster Grandparent Program	94.011 (72.001)	1,298,902	***
Social Security Administration:			
Social Security—Disability Insurance	96.001 (93.802)	153,861,307	A ***
Social Security—Research and Demonstration	96.007 (93.812)	124,108	***
Miscellaneous Grants and Contracts:			
Shared Revenue—Flood Control Lands	98.002	163,759	
Shared Revenue—Grazing Land	98.004	233,955	
College Housing Debt Service Grant	98.013	479,840	
U.S. Department of the Interior—Fire Prevention/Suppression Agreement	98.014	777,574	
U.S. Department of the Interior—Fire Prevention/Suppression Agreement	98.015	50,015	

The accompanying notes are an integral part of this schedule.
Endnotes appear on page 250.

Federal Agency/Program Title	Federal Catalog Number	Grant Amounts Received
U.S. Department of Agriculture and Various Other U.S. Department—Fire Prevention/Suppression	98.016	5,462,661
Miscellaneous Federal Receipts	98.099	514,173
Miscellaneous Uncleared Collections	99.999	<u>1,662,176</u>
Total Grants Received		<u>\$26,043,180,852</u>
Total Major Grants Audited in Compliance With OMB, Circular A-128		<u>\$25,332,222,632</u>

- A - The Bureau of State Audits reviewed these major grants for fiscal year 1994-95 in compliance with the OMB's Circular A-128.
- B - Major grant administered by the California State University was audited by other independent auditor in accordance with OMB Circular A-128.
- C - Other grant administered by the California State University was audited by other independent auditor in accordance with OMB Circular A-128
- O - The Bureau of State Audits reviewed this grant in conjunction with various reports issued from July 1, 1994, to December 31, 1995. See the Schedule of Audit Reports Involving Federal Grants from July 1, 1994, to December 31, 1995, beginning on page 257 for a description of these reports.
- * This amount includes cash and the value of commodities or cash and the value of food stamps.
- ** This amount represents the value of commodities only.
- *** The federal government changed the federal catalog number for fiscal year 1994-95. The number in parentheses represents the former federal catalog number.

The accompanying notes are an integral part of this schedule.
Endnotes appear on page 250.

**STATE OF CALIFORNIA
NOTES TO SCHEDULE OF FEDERAL ASSISTANCE
FISCAL YEAR ENDED JUNE 30, 1995**

1. General

The accompanying Schedule of Federal Assistance presents the total amount of federal financial assistance programs received by the State of California for the fiscal year ended June 30, 1995. This schedule does not include federal revenue received by the University of California. The revenues of the University of California are audited by other independent auditors in accordance with the Office of Management and Budget (OMB), Circular A-133, *Audits of Institutions of Higher Education and Other Nonprofit Organizations*. This schedule includes the federal assistance administered by the California State University (CSU).

2. Basis of Accounting

The OMB, Circular A-128, *Audits of State and Local Governments*, and the Single Audit Act of 1984 require the Schedule of Federal Assistance to present total expenditures for each federal assistance program. However, although the state accounting system separately identifies revenues for each federal assistance program, it does not separately identify expenditures for each program. As a result, the State prepares the Schedule of Federal Assistance on a revenue basis. Except for the federal assistance programs administered by the CSU as discussed in Note 4, the schedule shows the amount of federal funds and the estimated value of food stamps and commodities received by the State for the year ended June 30, 1995.

3. Definition of Major Program

The Single Audit Act of 1984 established the criteria for determining if a federal financial assistance program is a major federal program. The State considers federal financial assistance, including the value of food stamps and commodities of \$20 million or more, as major federal assistance programs.

4. California State University

The CSU receives federal assistance directly from the federal government and other sources. The federal assistance programs administered by the CSU are based on the expenditures/disbursements of grant funds. For fiscal year ended June 30, 1995, the CSU reported grant expenditures of approximately \$556 million, a figure that closely approximates the amount CSU received during that period. These federal grants were audited by other independent auditors in accordance with OMB, Circular A-128, *Audits of State and Local Governments*.

5. Other

In addition to the grants the State received, the State received \$3,600,000 in Petroleum Violation Escrow Funds that can be used to supplement five federal energy-related conservation and assistance programs. The funds were audited to the extent required by the OMB Circular A-128.

Table 5
Weaknesses in Compliance With Federal Regulations
by Grant Program

Federal Catalog Number	Grantor Agency/Program Title	Administering State Agency	Page Number	Number of Weaknesses					
				Inaccurate/ Inadequate/ Late Reports	Lack of Approval/ Insufficient Support for Expenditures	Insufficient Monitoring/ Auditing of Subrecipients	Inadequate Monitoring of Cash Balances/ Advances	Cash Management Issue	Other
Department of Agriculture									
10.553	School Breakfast Program	Department of the Youth Authority	215	1	1				
10.555	National School Lunch Program	Department of the Youth Authority	215	1	1				
10.557	Special Supplemental Food Program for Women, Infants, and Children	Department of Health Services	161		1				1
10.558	Child and Adult Care Food Program	California Department of Education	99			1			
10.568	Emergency Food Assistance Program	Department of Social Services	175			2			
Department of Housing and Urban Development									
14.228	Community Development Block Grants/State's Program	Department of Housing and Community Development	43	2	1	1	2	2	
14.239	Home Investment Partnerships Program	Department of Housing and Community Development	43	3	4	1			
Department of Justice									
16.579	Drug Control and System Improvement—Formula Grant	Office of Criminal Justice Planning	118	4	1	3			1

Federal Catalog Number	Grantor Agency/Program Title	Administering State Agency	Page Number	Number of Weaknesses					
				Inaccurate/ Inadequate/ Late Reports	Lack of Approval/ Insufficient Support for Expenditures	Insufficient Monitoring/ Auditing of Subrecipients	Inadequate Monitoring of Cash Balances/ Advances	Cash Management Issue	Other
Department of Labor									
17.225	Unemployment Insurance	Employment Development Department	153	1					
17.250	Job Training Partnership Act	Employment Development Department	153			3	1		
Department of Transportation									
20.205	Highway Planning and Construction	Department of Transportation	63		1				
Federal Emergency Management Agency									
83.516	Disaster Assistance	Office of Emergency Services	187	3	1				2
Department of Education									
84.002	Adult Education—State Administered Basic Grant Program	California Department of Education	99		1				
84.032	Federal Family Education Loans	California Student Aid Commission	96	1				1	1
84.048	Vocational Education—Basic Grants to States	California Department of Education	99	1					
		California Community Colleges, Chancellor's Office	67	1	3			1	
84.126	Rehabilitation Services—Vocational Rehabilitation Grants to States	Department of Rehabilitation	173			5			1

Federal Catalog Number	Grantor Agency/Program Title	Administering State Agency	Page Number	Number of Weaknesses						Other
				Inaccurate/ Inadequate/ Late Reports	Lack of Approval/ Insufficient Support for Expenditures	Insufficient Monitoring/ Auditing of Subrecipients	Inadequate Monitoring of Cash Balances/ Advances	Cash Management Issue		
84.164	Eisenhower Mathematics and Science Education—State Grants	California Postsecondary Education Commission	94			5				
84.181	Special Education - Grants for Infants and Families with Disabilities	Department of Developmental Services	148			1		1	2	
84.186	Safe and Drug-Free Schools—State Grants	Department of Alcohol and Drug Programs	141	1		4	1		1	
		Office of Criminal Justice Planning	118	4	1	4				
Department of Health and Human Services										
93.044	Special Programs for the Aging—Title III, Part B—Grants for Supportive Services and Senior Centers	Department of Aging	139			1				
93.045	Special Programs for the Aging—Title III, Part C—Nutrition Services	Department of Aging	139			1				
93.561	Job Opportunities and Basic Skills Training	Department of Social Services	175	1						
93.563	Child Support Enforcement	Department of Social Services	175			1				
		Department of Justice	198		1					
Department of Justice										
93.566	Refugee and Entrant Assistance—State Administered Programs	Department of Health Services	161			1				
		Department of Social Services	175			2				

Federal Catalog Number	Grantor Agency/Program Title	Administering State Agency	Page Number	Number of Weaknesses					
				Inaccurate/ Inadequate/ Late Reports	Lack of Approval/ Insufficient Support for Expenditures	Insufficient Monitoring/ Auditing of Subrecipients	Inadequate Monitoring of Cash Balances/ Advances	Cash Management Issue	Other
93.568	Low-Income Home Energy Assistance	Department of Community Services and Development	111		1			6	1
93.569	Community Services Block Grant	Department of Community Services and Development	111	1	2		2	6	1
93.574	Child Care For Families At-Risk of Welfare Dependency	California Department of Education	99	1					
		Department of Social Services	175		1				
93.656	Temporary Child Care and Crisis Nurseries Program	Department of Social Services	175	1		1			
93.658	Foster Care—Title IV-E	Department of Social Services	175	1					
93.659	Adoption Assistance	Department of Social Services	175	1					
93.667	Social Services Block Grant	Department of Social Services	175					1	
93.778	Medical Assistance Program	Department of Alcohol and Drug Programs	141	1					
93.802	Social Security—Disability Insurance	Department of Social Services	175	1					
93.917	HIV Care Formula Grants	Department of Health Services	161		1	2		1	
93.959	Block Grants for the Prevention and Treatment of Substance Abuse	Department of Alcohol and Drug Programs	141	1		2	1		1
93.994	Maternal and Child Health Services Block Grant to the States	Department of Health Services	161			2			

Federal Catalog Number	Grantor Agency/Program Title	Administering State Agency	Page Number	Number of Weaknesses					Other
				Inaccurate/ Inadequate/ Late Reports	Lack of Approval/ Insufficient Support for Expenditures	Insufficient Monitoring/ Auditing of Subrecipients	Inadequate Monitoring of Cash Balances/ Advances	Cash Management Issue	
Various Federal Departments									
	Numerous Federal Programs	Department of Health Services	161						1
	Numerous Federal Programs	California Department of Education	99			1		2	
	Numerous Federal Programs	Department of Social Services	175	2				2	
	Numerous Federal Programs	California Community Colleges, Chancellor's Office	67			3			
	Numerous Federal Programs	Department of Housing and Community Development	43	2	1			1	
	Numerous Federal Programs	Department of Community Services and Development	111		1				

**Schedule of Audit Reports
Involving Federal Grants From
July 1, 1994 to December 31, 1995**

From July 1, 1994, to December 31, 1995, the Bureau of State Audits issued reports on audits involving federal grants. The following schedule lists the reports issued and presents a summary of the report findings. The agencies' response to these findings are included in each of the separate audit reports.

Agency Receiving Federal Funds	Report Title and Description
Department of Health Services Medical Assistance Program 93.778	<p>The Department of Health Services' Information on Drug Treatment Authorization Requests (94012, 8-1-94)</p> <p>(1) From December 1993 through May 1994, the Department of Health Services (department) processed approximately 97 percent more drug treatment authorization requests (TARs) than in the first six months of our review. However, the department also increased its total backlog of TARs from 1,452 at the end of November 1993 to 5,970 TARs at the end of May 1994.</p> <p>(2) During the six-month period December 1993 through May 1994, the department generally did not meet the state requirements to process mailed TARs within five days. The Stockton drug unit met the requirement in four of the six months, while the Los Angeles drug unit met the five-day requirement in only two of the six months. The extended processing time in the Los Angeles drug unit was primarily caused by the effects of the Northridge earthquake on January 17, 1994.</p> <p>(3) From December 1993 through May 1994, the Stockton drug unit processed 80 percent of the TARs received by telephone facsimile machines (FAX) within 24 hours of receipt, as federal law requires. The Stockton drug unit processed the remaining 20 percent of the TARs within 26 hours of receipt. The Los Angeles drug unit processed 81 percent of the TARs received by FAX within 24 hours of receipt and 74 percent of the TARs received by the department's audio response telephone system—Voice Drug TAR System—within 24 hours of receipt.</p>
Employment Development Department Trade Adjustment Assistance— Workers 17.245	<p>Investigative Activity Report and Public Reports of Investigations Completed by the Bureau of State Audits from January 1 through July 31, 1994 (194-2, 9-14-94)</p> <p>(1) A program manager at a branch office of the Employment Development Department violated federal, state, and departmental conflict-of-interest laws, regulations, and standards during the awarding of more than \$770,000 in state contracts to a company in which she had a financial interest. Although the program manager told her supervisor about her relationship with</p>

Agency Receiving Federal Funds	Report Title and Description
	<p>the company, her disclosure was delinquent. Her supervisor inappropriately failed to remove her from this position after she disclosed her financial interest in the company.</p>
<p>Public Employees' Retirement System through various departments</p> <p>Various Federal Grants</p>	<p>A Review of Service-Related Disability Retirements at Three Retirement Systems (93105, 10-6-94)</p> <p>(1) According to Section 21300 of the California Government Code, the Public Employees' Retirement System (PERS) may reduce or eliminate a member's ordinary disability retirement (ODR) monthly pension if that member earns income after retirement from a job that is not in state service, but the PERS cannot do so for any member who receives industrial disability retirement (IDR) benefits. If Section 21300 is amended to allow the PERS to apply earnings limitations to members with earned income who receive IDR benefits, it will save approximately \$1.8 million a year by reducing pensions for the 214 members included in our sample, and a total of \$7.2 million by the time those members reach the age of 50.</p>
<p>Department of Health Services</p> <p>Medical Assistance Program 93.778</p>	<p>The Department of Health Services' Information on Drug Treatment Authorization Requests (95012, 2-1-95)</p> <p>(1) From June 1994 through November 1994, the Department of Health Services (department) processed approximately 177 percent more drug treatment authorization requests (TARs) than it did in the first six months of our review in 1990. The department had a backlog of 2,344 unprocessed TARs in November 1994. In comparison, its backlog of unprocessed TARs in November 1990 was 2,311.</p> <p>(2) The department was not able to process its TARs in a timely manner from June 1994 through November 1994. According to its own calculations, the department was not able to process mail-in TARs within five working days as required by law in five of the six months at the Stockton drug unit and in all six months at the Los Angeles drug unit.</p> <p>(3) The department generally did not process TARs received by FAX within 24 hours of receipt, as federal law requires. Based on samples of TARs randomly selected at each drug unit, an average of 107 hours was required to process a FAX TAR in the Los Angeles drug unit, and an average of 29 hours was required to process a FAX TAR in the Stockton drug unit in August 1994. During that month, the department processed only 5 percent of the FAX TARs in our sample within 24 hours. Finally, during August and November 1994, the Los Angeles drug unit did not meet the 24-hour turnaround requirement for TARs received via the department's audio response telephone system—the Voice Drug TAR System (VDTs). In our sample of 53 VDTs TARs, only 65 percent were processed within 24 hours.</p>

Agency Receiving Federal Funds	Report Title and Description
Department of Social Services Family Support Payments to States—Assistance Payments 93.560	<p>Department of Social Services: Review and Assessment of the Cost Effectiveness of AFDC Fraud Detection Programs (94023, 3-29-95)</p> <ol style="list-style-type: none"> (1) The early and continuing fraud programs for Aid to Families with Dependent Children (AFDC) are cost effective. The program returns between \$6 and \$67 in fraud costs avoided to the state, federal, and county governments for every \$1 spent on early fraud prevention and detection activities. The program returns between \$3 and \$12 in fraud costs avoided to state, federal, and county governments for every \$1 spent on continuing fraud prevention and detection activities. (2) The cost effectiveness of the AFDC fraud programs is difficult to calculate. We noted errors in counties' accumulation of fraud activity, instances where the key statistical reports were not prepared in accordance with Department of Social Services' (department) instructions, inadequate instructions from the department regarding the preparation of key statistical reports, and the use of outdated information for calculation of the average length of time on aid. Although the department cannot calculate the cost effectiveness of the AFDC fraud programs with precision, variances in the factors used in the calculation would not likely affect the overall conclusions about the programs' cost effectiveness. (3) The department should improve management and oversight of the AFDC fraud programs. The department could improve the quality and consistency of the data by providing thorough written instructions for data retention requirements, formal training classes, desk review of submitted reports, field audits of supporting documentation, and continual feedback to the counties.
Department of Social Services Various Federal Grants	<p>Department of Social Services: The Department's Approach to Welfare Automation Is Too Costly and Unlikely To Succeed (94021, 4-18-95)</p> <ol style="list-style-type: none"> (1) The Department of Social Services (department), in organizing and conducting its activities to provide welfare automation to counties, has failed to deliver a statewide system. The complexity of this project has overwhelmed the department's ability to manage it. As a result, statewide welfare automation may not be available until the year 2000, ten years after the original plan for complete implementation. (2) The department will spend \$166 million to automate 14 of the 58 counties in California. Projected costs for statewide automation may exceed \$1 billion, \$455 million over original department budget estimates. Some of the savings expected by the department from automation may be neither attainable nor sufficient to recover projected costs for nearly ten years. Further, the approach chosen for automating the 14 interim

Agency Receiving Federal Funds

Report Title and Description

Statewide Automated Welfare Systems (SAWS) is unlikely to succeed as a cost-effective approach to statewide automated welfare.

- (3) The State is bearing full financial risk for making sure the automated system performs as originally planned. The department is not requiring its hardware supplier or its software maintenance vendor to meet system availability or response time standards and has not established a fixed price to meet performance objectives.
- (4) The department is unable to tell the Legislature how much it has spent to date on welfare automation and has not tracked actual cumulative costs to budget estimates since the Legislature initiated the SAWS in 1984. The department has made and is planning further expensive and unnecessary enhancements to the automated system, but it has no evaluation plan that would result in an unequivocal recommendation to continue with or cease the project.

Department of Health Services

State Survey and Certification of
Health Care Providers and
Suppliers
93.777

Department of Health Services: The Orange County District Office Needs to Further Improve its Oversight of Health Care Facilities (94117, 7-27-95)

- (1) The Department of Health Services Orange County District Office (district office) responded from one to 213 days late for 35 percent of the complaints reviewed relating to health care facilities, with late responses in all three fiscal years reviewed from July 1992 through March 1995. In addition, the district office incorrectly assessed priority levels for 2 of 60 complaints reviewed.
- (2) The district office has not established guidelines for timely investigations and processing of citations and deficiency notices and, as a result, took longer than allowed to investigate and process them. The district office issued deficiency notices instead of higher level citations in 4 of 20 cases reviewed, and issued 29 percent of the citations we reviewed from 2 to 12 days late.
- (3) The district office did not perform all required inspections of health care facilities during our review period and performed some inspections late. In addition, the district office did not always ensure health care facilities submitted timely plans of corrective action, as required, in 13 of 20 cases reviewed.

Department of Health Services

Medical Assistance Program
93.778

Department of Health Services: Drug Treatment Authorization Requests Continue To Increase (95011, 8-1-95)

- (1) From December 1994 through May 1995, the Department of Health Services (department) processed approximately 319 percent more drug treatment authorization requests (TARs) than it did in the first six months of our review in 1990. The

Agency Receiving Federal Funds

Report Title and Description

department had a backlog of 1,113 unprocessed TARs in May 1995. In comparison, its backlog of unprocessed TARs in November 1990 was 2,311.

- (2) During the six-month period of December 1994 through May 1995, both of the department's drug units (located in Stockton and Los Angeles) generally met the state requirement for processing mailed-in TARs. We also found that the Stockton drug unit processed 92 percent of its FAX TARs within 24 hours of receipt; however, the Los Angeles drug unit processed only 53 percent of its FAX TARs within 24 hours of receipt. The average turnaround time for all FAX TARs reviewed at Los Angeles was 29 hours. Finally, during January and April 1995, the Los Angeles drug unit generally met the 24-hour turnaround requirement for TARs received via the Voice Drug TAR System (VDTS).
- (3) From December 1994 through May 1995, 84 fair hearing requests were submitted to the Department of Social Services to appeal a denied TAR, which represents a 31 percent increase over the six months ending November 1994. Of those, 4 were dismissed, 39 were withdrawn before the cases were heard, 3 were denied, 3 were approved, and the decisions on the remaining 35 were still pending at the time of our review. In addition, the department reported that it received few or no complaints from providers related to the amount of time taken to process TARs from December 1994 through May 1995.

Department of Education

Child Care and Development
Block Grant
93.575

Department of Education: Has Not Spent Millions for Child Care and Development Services (94111, 8-2-95)

- (1) The Department of Education (department) could not tell us the demand for services offered by the child care and development programs it funded during fiscal years 1991-92 through 1993-94. The department also could not tell us the actual number of children currently served by its programs. In April 1995, the department reported to the Legislature that California provides subsidized child care and development services to less than 20 percent of eligible low-income families.
- (2) The department did not maximize its efforts to ensure the delivery of child care and development services; therefore, millions of dollars in state and federal funds remain unspent. For example, contractors providing child care and development services did not spend \$84.7 million that the department had allocated them. In addition, the department did not allocate all of the Federal Child Care and Development Block Grant funds it received.

Agency Receiving Federal Funds	Report Title and Description
	(3) Two department practices for reviewing and scoring applications for awarding child care and development contracts increased the risk that biased scoring decisions were made. In addition, the department did not consistently process appeals of contract awards, and the department's process for reviewing annual audit reports submitted by contractors was deficient.
Department of Forestry and Fire Protection Cooperative Forestry Assistance 10.664	Investigations of Improper Governmental Activities: January 1 through June 30, 1995 (I95-2, 8-8-95) (1) A manager at the California Department of Forestry (CDF) made gifts of public funds in the form of Smokey Bear merchandise to state employees, volunteers, and others. The manager also authorized unnecessary and wasteful purchases of Smokey Bear memorabilia and related materials. Finally, the manager placed personal long-distance calls at the State's expense.
Department of Rehabilitation Rehabilitation Services— Vocational Rehabilitation Grants to States 84.126	Department of Rehabilitation: Business Enterprise Program for the Blind Financial Report Year Ended June 30, 1994 (93031, 8-22-95) (1) The financial condition of the Department of Rehabilitation's (department) Business Enterprise Program for the Blind (program) is sound. The program's revenues exceeded its expenses by approximately \$1 million. At June 30, 1994, the program had approximately \$4 million in cash and pooled investments, and its total assets exceeded its total liabilities by approximately \$14 million. (2) Although the financial condition of the program is sound, certain weaknesses were noted in the internal control structure. Specifically, the department does not ensure that it receives all monthly operating reports, fees, vending machine commissions, and loan payments due from blind vendors. In addition, the department improperly used federal funds to pay for parts and materials associated with equipment repair, did not accurately report its liabilities at June 30, 1994, and has not adequately separated certain incompatible duties.
Department of Forestry and Fire Protection Donation of Federal Surplus Personal Property 39.003	Department of Forestry and Fire Protection: A Review of Allegations Concerning the State's Management of the Federal Excess Personal Property Program (94101, 11-21-95) (1) The Bureau of State Audits reviewed the California Department of Forestry (CDF) investigation of 28 allegations relating to potential theft and misuse of aircraft and aircraft parts loaned to the CDF through the Federal Excess Personal Property Program (FEPP). The CDF determined that no action was called for in five of the allegations. The CDF took defensible disciplinary or corrective action for eight allegations. No additional action was necessary for eight other allegations because the evidence did not substantiate the allegation, and no

action was necessary for four allegations because the evidence did not indicate a violation of any law or regulation. However, for three allegations, the CDF determined that its employees did not comply with state or federal regulations.

- (2) A review of the CDF's internal controls over the acquisition, disposal, loan, security, and physical inventory count revealed several weaknesses. The CDF is not counting, tagging, and reconciling its FEPP inventory, and it does not accurately record FEPP property in its inventory records. In addition, the CDF is not adequately safeguarding its FEPP property.

**Schedule of Minor Federal Issues for
Year Ended June 30, 1995**

Agency Receiving Federal Funds	Federal Grant and Federal Catalog Number	Description of Issue
California Community Colleges, Chancellor's Office	Job Opportunities and Basic Skills Training 93.561	(1) During our testing of expenditures related to this program, we found that the Chancellor's Office paid \$62.50 for rental car charges that were incurred during non-working hours.
		(2) The Chancellor's Office did not properly match federal funds by approximately \$20,000. Although the Chancellor's Office was aware of this matching problem, it had not corrected the problem at the time of our testing; however, it has since corrected this matching problem.
	Vocational Education—Basic Grants to States 84.048	(3) We tested 27 invoices for reimbursement of expenditures and found that for 5 invoices the Chancellor's Office either held federal funds too long or delayed its requests for federal funds. As a result, the State's General Fund lost net interest earnings of approximately \$2,500.
California Student Aid Commission	Federal Family Education Loan Programs 84.032	(1) The commission made a clerical error on its fiscal year 1994-95 potential interest calculation schedule for the Cash Management Improvement Act of 1990. The commission reported \$3,367,317 instead of \$1,868,866.59 for the U.S. Department of Education's portion of money collected on defaulted student loans for the December 1994 reporting period. This error did not affect any of the interest calculations.
		(2) The lender is entitled to reimbursement when a bankrupt borrower defaults on a student loan. For one of five such claims we reviewed, the commission paid the lender even though the lender did not include a copy of the student's loan application in the claim package, as required.

Agency Receiving Federal Funds	Federal Grant and Federal Catalog Number	Description of Issue
Developmental Services, Department of	Special Education—Grants to Infants and Families With Disabilities 84.181	(3) For 1 of the 40 defaulted student loans we reviewed, the commission was 25 days late in paying the lender for the defaulted loan.
		(4) For 6 of 40 defaulted student loans we reviewed, the commission paid the lenders for the defaulted loan even though the lenders did not send written delinquency notices to the borrower within ten days of the first missed payment. The lenders were between one to eight days late in sending out the written notices.
Education, California Department of	Various	(1) The department made a clerical error when preparing its Federal Cash Transaction Report 272 for the quarter ended June 30, 1995, and as a result, overstated the total expenditures reported and understated cash on hand by approximately \$550,000. Since the report is cumulative, the department's reported cash on hand balance is also incorrect on subsequent cash transaction reports.
		(1) The department tried to resolve instances of noncompliance with federal regulations identified in the audit reports of one Local Educational Agency (LEA) and a County Office of Education within six months but the agencies did not cooperate with the department.
	Title I Grants to Local Educational Agencies 84.010	(2) The department did not reduce the entitlement by \$298 of a LEA that failed to maintain the required level of effort even though the department did not grant the LEA a waiver to the maintenance of effort requirement. The department subsequently granted a waiver in fiscal year 1995-96.

Agency Receiving Federal Funds	Federal Grant and Federal Catalog Number	Description of Issue
Emergency Medical Services Authority		(3) The department computed the level of effort incorrectly for five LEAs because it failed to include deficits from the cafeteria fund. However, the error did not affect the LEA's compliance with the level of effort requirement. The department subsequently revised its calculation of LEA's level of effort in the fiscal year 1995-96.
	Payments to States for Child Care Assistance 93.575	(4) The department has not received the required approval from the Department of General Services (DGS) and the Department of Finance (DOF) for the funding terms and conditions in contracts the department enters into with providers of services under the Payment to States for Child Care Assistance Program. To obtain greater efficiency in the execution of these contracts, the state laws require that the funding terms and conditions included in the contracts be approved by the DGS and the DOF.
Emergency Medical Services Authority	Preventive Health and Health Services Block Grant 93.991	(1) The Emergency Medical Services Authority (EMSA) charged its federal program 100 percent for an office technician's salary even though one third of the employee's duties involved general office administrative tasks that were unrelated to the federal program. The chief of EMSA's Funding and Administrative Division believes that this is appropriate because the EMSA charged a budget analyst's position 100 percent to the State's General Fund even though one third of that employee's duties involved activities related to the federal program.
Employment Development Department	Employment Service 17.207 Employment and Training Assistance— Dislocated Workers 17.246	(1) We tested 78 of the department's calculations of days it held federal funds, as reported on the Cash Management Improvement Act worksheets, and found that 2 were incorrect. In both instances, the department reported that it held federal funds for six days, when the funds had been held for only five days.

Agency Receiving Federal Funds	Federal Grant and Federal Catalog Number	Description of Issue
Health Services, Department of	Employment Service 17.207	(2) We reviewed five employees who charged time to this grant and found that one employee's timesheet was not approved by a supervisor.
	Job Training Partnership Act 17.250	(3) Two clerical errors were noted in our testing of the department's cost compliance analysis. As a result of one of these errors, the department concluded that a subrecipient spent Job Training Partnership Act funds within allowable limits when in fact, it had not.
	Special Supplemental Food Program for Women, Infants, and Children 10.557	<p>(1) The department was 13 days late in performing its May 1995 reconciliation of food vouchers issued with food vouchers redeemed through the WIC program and was 44 days late in performing its June 1995 reconciliation. Federal regulations require the reconciliations to be prepared within 150 days of the first date of authorized use.</p> <p>(2) One of 48 food vouchers we tested had not been stamped by the authorized vendor. The redemption of vouchers that are not stamped by the redeeming vendor could result in the redemption of vouchers by unauthorized vendors. The same voucher had also been improperly used prior to the issue date.</p> <p>(3) For the first nine months of the fiscal year, the department's review procedures did not address one of the seven monitoring criteria, civil rights, specified in the Code of Federal Regulations. The department subsequently revised its review procedures, performed under contract by the State Controller's Office (SCO), to specifically address all seven requirements.</p>

Agency Receiving Federal Funds	Federal Grant and Federal Catalog Number	Description of Issue
Industrial Relations, Department of	Occupational Safety and Health 17.500	(4) During fiscal year 1994-95, the department incurred unnecessary administrative costs because it did not always use the special form that identified claim schedules requiring expedited processing under the Cash Management Improvement Act of 1990. In June 1995, the department began requiring its staff to use this form.
		(1) In one instance, the department held federal funds for 50 days prior to disbursement.
		(2) For 2 of 15 files reviewed, the department did not open a case file in response to a complaint within the required 14 days. In these two instances, the department was 5 and 22 days late.
		(3) For 1 of 15 files reviewed, the department did not send a resolution letter within the required 21 days of closing a complaint investigation. In this instance, the department was at least five months late.
Mental Health, Department of	Block Grants for Community Mental Health Services and Mental Health Disaster Assistance and Emergency Mental Health Program 93.958 93.982	(4) The department did not adequately inform its employees of the requirements related to the Drug-Free Workplace Act and did not maintain an ongoing drug-free awareness program.
		(1) The department submitted its final program report for the immediate services portion of the grant on March 31, 1996, 592 days after the due date of August 17, 1994. Further, as of April 9, 1996, the department had not submitted two other required reports due by August 17, 1994. (2) As of April 9, 1996, the department had not submitted the "regular program" portion of its final grant report. This report was due on November 17, 1995.

Agency Receiving Federal Funds	Federal Grant and Federal Catalog Number	Description of Issue
		(3) State employees comprised 54 percent of the membership of the State Mental Health Planning Council, more than the 50 percent limit allowed by federal regulations.
Seismic Safety Commission, Department of	Federal Emergency Management Agency/ Cooperative Agreement 83.999	(1) The commission does not have an ongoing policy for ensuring that its employees are aware of the requirements of the Drug-Free Workplace Act.
Social Services, Department of	Food Stamps 10.551	(1) We reviewed 26 county Status of Claims Against Households reports (FNS-209) and found that 7 lacked the signature of a county representative certifying that the amounts reported were correct.
	Foster Care—Title IV-E 93.658	(2) As in prior years, the department completed only six of the nine-page quarterly statement of expenditures for the Foster Care—Title IV-E Program. The department believes that it would require extensive system modifications and staff time to fully complete this report.
	Social Services Block Grant 93.667	(3) We reviewed 24 payments to In-Home Supportive Services providers and found that the department overpaid two providers \$13 and \$9.
	Social Security Disability Insurance 93.802	(4) One of 16 employees we tested who charged time to this grant did not submit an absence report for March 1995. (5) Two of the 15 invoices we reviewed were not properly authorized for payment.
		(6) The amounts reported in the Federal Cash Transaction Report for the program did not agree to the department's supporting records. The \$261 difference occurred because the department recorded a program expenditure in the wrong year.

Agency Receiving Federal Funds	Federal Grant and Federal Catalog Number	Description of Issue
Various		(7) Because of an input error, the department overcharged federal programs approximately \$2,700 of indirect costs. After we brought this error to the department's attention, it corrected the error and reallocated the indirect costs.
State Controller's Office	Various	<p>(1) The SCO did not complete the single audits of two local education agencies for June 30, 1994 by the required deadline of June 30, 1995. The first audit was more than one month late and the second audit was more than four months late.</p> <p>(2) The SCO was not able to locate two of its subrecipients' audit reports in its files. Without these reports, the SCO could not provide us with support for its conclusion that it was not required to review the two reports because the subrecipients received less than \$25,000 in federal monies. Included in the audit report is the schedule of federal financial assistance that provides detail of the federal monies received by a subrecipient.</p> <p>(3) In its monitoring of subrecipients' audit reports, the SCO did not detect that one audit report for the current year failed to address the status of a prior-year finding.</p>
Traffic Safety, Office of	State and Community Highway Safety Program 20.600	(1) The office submitted its final report for the grant for fiscal year 1994-95 on March 29, 1996, 89 days late.

Report on Compliance With State Laws and Regulations

Independent Auditors' Report on Compliance With State Laws and Regulations

The Governor and the Legislature of
the State of California

We have audited the general purpose financial statements of the State of California as of and for the year ended June 30, 1995, and have issued our report thereon dated December 15, 1995. We did not audit the financial statements of the pension trust funds, which reflect total assets constituting 81 percent of the fiduciary funds. We also did not audit the financial statements of certain enterprise funds, which reflect total assets and revenues constituting 87 percent and 91 percent, respectively, of the enterprise funds. In addition, we did not audit the University of California funds. Finally, we did not audit the financial statements of certain component unit authorities, which reflect total assets and revenues constituting 97 percent and 95 percent, respectively, of the component unit authorities. The financial statements of the pension trust funds, certain enterprise funds, the University of California funds, and certain component unit authorities referred to above were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for these funds and entities, is based solely upon the reports of other independent auditors.

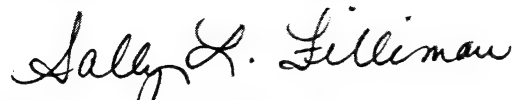
We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement.

The State's management is responsible for compliance with laws, regulations, contracts, and grants applicable to the State of California. As part of obtaining reasonable assurance about whether the general purpose financial statements are free of material misstatement, we performed tests of the State of California's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests indicate that, with respect to the items tested, the State of California complied, in all material respects, with the provisions referred to in the preceding paragraph. With respect to items not tested, nothing came to our attention that caused us to believe that the State of California had not complied, in all material respects, with those provisions. However, we noted certain immaterial instances of noncompliance that we have reported to the management of agencies of the State of California. We discuss these on pages 35 through 216 of this report.

This report is intended for the information of the Governor and Legislature of the State of California and the management of the executive branch. However, this report is a matter of public record and its distribution is not limited.

BUREAU OF STATE AUDITS

A handwritten signature in cursive script, reading "Sally L. Filliman".

SALLY L. FILLIMAN, CPA
Deputy State Auditor

April 15, 1996

**Appendix Reports Issued by the Bureau of State Audits
From July 1, 1994, to December 31, 1995**

Date of Issue	Report Title	Report No.
<u>1994</u>		
Jul 18	Restrictive Implementation Schedules Effectively Limited Competition for the California State Lottery's New On-Line Gaming System	93119
Jul 26	The Adelanto Redevelopment Agency Needs to Improve Its Procedures To Comply With the Community Redevelopment Law	93112
Aug 1	The Department of Health Services' Information on Drug Treatment Authorization Requests	94012
Aug 17	The Department of Motor Vehicles and the Office of Information Technology Did Not Minimize the State's Financial Risk in the Database Redevelopment Project	94107
Aug 22	A Review of the Department of Education's Cost and Development of the California Learning Assessment System	94109
Sep 14	Investigative Activity Report and Public Reports of Investigations Completed by the Bureau of State Audits from January 1 through July 31, 1994	194-2
Oct 6	A Review of Service-Related Disability Retirements at Three Retirement Systems	93105
Oct 12	Treasurer's Cash Count (October 31, 1993)	93007
Nov 22	Employees of the University of California, San Francisco, Improperly and Illegally Managed the Center for Prehospital Research and Training	1930279
Dec 7	The State Needs To Reengineer Its Management of Information Technology	94022
<u>1995</u>		
Jan 5	State Treasurer's Cash Count (March 31, 1994)	94005
Jan 18	Status Report of the Orange County Treasurer's Office	94026.1

Date of Issue	Report Title	Report No.
Feb 1	The Department of Health Services' Information on Drug Treatment Authorization Requests	95012
Feb 2	Status Report on the Orange County Treasurer's Office	94026.2
Feb 8	Investigations of Improper Governmental Activities August 1 Through December 31, 1994	195-1
Feb 24	The State's Use of Transportation Funds Allowed by the 1989 Transportation Blueprint Legislation	94014
Mar 1	The Medical Board Needs To Maximize Its Recovery of Costs	93032
Mar 1	A Review of the State's Bond Sales for 1993 and 1994	94016
Mar 28	Orange County: Treasurer's Investment Strategy Was Excessively Risky and Violated the Public Trust	94026.3
Mar 29	Department of Social Services: Review and Assessment of the Cost Effectiveness of AFDC Fraud Detection Programs (Contract audit by Deloitte and Touche)	94023
Mar 30	State Architect: Contracting Practices Need Improvement	94024
Apr 3	Treasurer's Cash Count (June 30, 1994)	94006
Apr 5	State of California: Statement of Securities Accountability of the State Treasurer's Office, June 30, 1994	94008
Apr 18	Department of Social Services: The Department's Approach to Welfare Automation Is Too Costly and Unlikely To Succeed (Contract audit by Ernst & Young)	94021
Apr 27	State of California: Financial Report Year Ended June 30, 1994	94001
May 22	Report of the Orange County Restructuring Plan	95107
Jun 13	County Investments: Treasurers Should Avoid Risky Investment Strategies	95101
Jun 21	State of California: Financial and Compliance Weaknesses Have a Cumulative Effect on the State's Operations	94002
Jun 21	State Treasurer's Cash Count (September 30, 1994)	94007
Jun 27	State Treasurer's Cash Count (January 31, 1995)	95005

Date of Issue	Report Title	Report No.
Jun 30	State of California: Single Audit Report Year Ended June 30, 1994	94003
Jul 27	Department of Health Services: The Orange County District Office Needs To Further Improve Its Oversight of Health Care Facilities	94117
Aug 1	Department of Health Services: Drug Treatment Authorization Requests Continue To Increase	95011
Aug 2	Department of Education: Has Not Spent Millions for Child Care and Development Services	94111
Aug 8	Investigations of Improper Governmental Activities January 1 Through June 30, 1995	195-2
Aug 22	Department of Rehabilitation: Business Enterprise Program for the Blind Financial Report, Year Ended June 30, 1994	93031
Sep 12	State Departments: Many Do Not Comply With Consultant Contract Requirements	94015
Sep 13	Los Angeles County Metropolitan Transportation Authority	95117
Oct 11	Department of Fish and Game: Administrative Processes Need Improvement	94106
Nov 1	Trade and Commerce Agency: The Effectiveness of the Employment and Economic Incentive and Enterprise Zone Programs Cannot Be Determined	93109
Nov 15	Department of Motor Vehicles: No Firefighters' License Plates Have Been Issued to the Public	93033
Nov 15	Department of Motor Vehicles: Collegiate License Plate Revenues Have Been Overallocated	95020
Nov 21	Department of Forestry and Fire Protection: A Review of Allegations Concerning the State's Management of the Federal Excess Personal Property Program	94101
Nov 29	CSU and UC: Campuses Generally Provide Access for Students With Disabilities	94120

Date of Issue	Report Title	Report No.
Dec 12	Student Aid Commission: Problems Continue With Its Automated Financial Aid Processing System	95021
Dec 12	Treasurer's Cash Count (May 31, 1995)	95007

DEPARTMENT OF FINANCE

OFFICE OF THE DIRECTOR
STATE CAPITOL, ROOM 1145
SACRAMENTO, CA 95814-4998



June 25, 1996

Mr. Kurt R. Sjoberg
State Auditor
660 J Street, Suite 300
Sacramento, CA 95814

Dear Mr. Sjoberg:

STATE OF CALIFORNIA: IMPROVEMENTS HAVE OCCURRED IN CONTROLLING
COSTS, BUT SOME PROBLEMS REMAIN

Thank you for the opportunity to respond to the statewide issues which you've identified. We also appreciate your recognition of improved control over many of the expenditures the State incurs.

This report was the result of your examination of the State's general purpose financial statements for the Fiscal Year-ended June 30, 1995. The report will be part of the Single Audit Report covering Fiscal Year 1994-95. Although our systems can always be improved, the fact that the cumulative findings do not adversely affect the State's general purpose financial statements is evidence that the State's operations are materially under control.

California is an entity with numerous programs and activities being carried out for its citizens and is much more complex and vast than most economic entities in the world. Such complexity, along with budget constraints, challenge us to not only meet the requirements of those programs and activities, but to do so in a manner that is effective and efficient. Moreover, such operations must exist within a system of internal control that safeguards assets and resources and produces reliable financial information. Attaining these objectives and overseeing the financial and business practices of the State continues to be an important aspect of the Department of Finance's leadership for the State.

In meeting our responsibility for financial leadership and oversight, the Department of Finance conducts internal control reviews of state departments and reviews areas of potential weakness in the State's fiscal systems. In addition, we provide oversight of internal audit units at individual departments, including the providing of audit guidelines and conducting quality assurance reviews of their work. Further, two years ago, we started a process of issuing Audit Memos to departments to establish policy or provide technical advice on various audit related

issues. We will be issuing an Audit Memo to highlight the statewide issues that you have identified, to remind departments of their responsibilities to resolve such issues, and to provide some guidance for them to resolve such issues.

The Department of Finance provides leadership, assistance and oversight of financial and business practices. However, the head of each agency is responsible for establishing and maintaining a system of internal controls within their agency. This responsibility includes documenting the system, communicating system requirements to employees, and assuring that the system is functioning as prescribed and is modified for changes in conditions. Moreover, all levels of management of state agencies must be involved in assessing and strengthening the systems of internal controls to minimize fraud, errors, abuse, and waste of government funds.

Each department for which you have identified internal control weaknesses is responsible and is held accountable for developing corrective action plans. We will monitor the corrective actions included in their responses to your findings.

Our response to each of the statewide concerns that you have identified in your report follows.

LEASING INFORMATION IS INADEQUATE

As indicated in your report, there are some state agencies for which the Department of General Services (DGS) does not have oversight responsibility. In order to include the information for these entities in the DGS records, it may be necessary to make the submission of this information a legal requirement. The information currently included in DGS records does not include some of the information needed for GAAP requirements. Since the information currently maintained by DGS is primarily for internal management purposes, acquiring and maintaining additional information would be an increased cost to DGS, and it may not be cost-effective. The DGS is currently addressing the issue of expanding their database on leasing information to include additional information.

AGENCIES ARE NOT REQUIRED TO PREPARE ALL RECONCILIATIONS OR REPORTS OF ACCRUALS

As we reported to you before, efforts are underway to consolidate and revise year-end reports. In addition, as resources become available, the issue of requiring full reporting for all fund types will be researched and developed.

INADEQUATE POLICY FOR RECONCILING DIFFERENCES IN FUND BALANCE

The Controller's Office prepares a preliminary report only for the General Fund. This report is generally prepared late in the process of developing the Governor's Budget. However, within time constraints, the Department of Finance works closely with the Controller's Office to reconcile major differences between our budget documents and the Controller's preliminary report. Schedule 7 in the Governor's Budget Summary volume lists the major reconciling items. Upon publication of the Controller's Annual Report, after the Governor's Budget is issued, changes made by the Controller to the preliminary report figures are reviewed and generally are reflected in the May Revision to the Governor's Budget.

Regarding Special Funds, the parent department for a fund has the primary responsibility for preparation of the Fund Condition Statements to be included in the Governor's Budget. This is especially true for the past year presentation which should reflect the actual expenditures, revenues, and transfers reported in their annual financial statements. The extent of the Department of Finance involvement in reconciling budget amounts to the Controller's Office prior to publication of the budget is dependent on a number of factors. These factors include the progress of the Controller's Office in compiling and/or reconciling data for a particular fund, the reliability and experience of departmental accounting and budgeting staff, and the sensitivity and issues pertinent to a particular fund. After the Controller's Office issues the Annual Report, there is no formal reporting or updating of special funds, since the May Revision process focuses on the General Fund. However, Department of Finance staff may compare fund information in the Controller's Report to the budget on a selective basis. The extent of this review and/or reconciliation will again depend on the materiality of any changes and the sensitivity of the fund.

Both the Department of Finance and the Controller's Office recognize the time constraints which exist in reconciling the budget amounts and the Controller's reports. An effort is underway to explore an automated comparison of revenue and expenditure databases of the two agencies. The initial effort will be limited to the General Fund.

DEFICIENCIES EXIST IN ACCOUNTING FOR AND CONTROLLING STATE EQUIPMENT

As you reported, the State Administrative Manual provides guidelines on accounting for state equipment. This is an area where our own auditors continue to find deficiencies. We will issue an Audit Memo identifying this and other statewide issues, and direct the Departments to comply with applicable requirements. In addition, we will increase emphasis on this area in our internal control reviews.

STATEWIDE REAL PROPERTY INVENTORY IS INCOMPLETE

We will include in our review of required year-end reports consideration of the feasibility of requiring departments to reconcile the amounts reported in the Statewide Real Property Inventory with their Statement of Changes in General Fixed Assets.

PROCEDURES FOR FEDERAL PROGRAMS ARE DEFICIENT IN CASH MANAGEMENT

Default Procedures Provisions (\$3 million). We could not comply fully with the 1994-95 Default Procedures because we disagreed with some of its provisions. The specific provisions concerned: (1) advance funded payroll expenditures (\$577,500), (2) redemption patterns (\$228,800), (3) direct cost reimbursement (\$190,200), and (4) Federal Family Education Loan (FFEL) program (\$2 million). The disagreement over the FFEL program has been resolved. As indicated in the report, we will refund in June 1996 to the federal government the \$2 million that was offset against the February 1996 interest payment. However, we are still negotiating with the Financial Management Service (FMS) on the other three provisions and the payment of the remaining amounts.

State Departments' Reporting Errors (\$29,000). The departments' errors in reporting federal fund amounts totaled \$9.6 million for there programs. The total federal funds reported to the Department of Finance by the departments for interest liability calculations was \$17.2 billion. The error rate for reporting federal fund amounts is .06%. Also, the departments' errors in reporting interest days had a minor impact on the interest liability.

DOF Calculating Errors (\$14,000). The net total interest liability calculated was \$8.6 million. The \$14,000 calculating error for two programs represents a 0.2% error rate. We will continue to make every effort to minimize any calculating errors. Refinements in the computer spreadsheet program and review of the spreadsheet formulas and reports should minimize the calculation differences.

In summary, the report identified an understated state liability of approximately \$3 million. As explained above, \$2 million for the FFEL program will be paid in June 1996. The \$1 million for the Default Procedures provisions is subject to further negotiation. Any additional payment will depend on the outcome of the negotiations with FMS. The \$43,000 for reporting and calculating errors will be included as an adjustment in the 1995-96 Annual Report and paid to the federal government in February 1997.

DEPARTMENTS DO NOT PROMPTLY REQUEST THE TRANSFER OF FEDERAL FUNDS AND ADVANCES TO SUBRECIPIENTS ARE INADEQUATELY MONITORED

The monitoring of all funds to subrecipients, including cash advances, is the responsibility of individual state agencies and specific requirements are found in Section 20050 of the State Administrative Manual.

We have previously addressed this issue, as well as the issue of promptly requesting federal funds, through statewide Audit Memos to departments during 1994. We will reissue these Audit Memos to remind departments of their responsibilities.

EXPENDITURES AND RECEIPTS FOR EACH FEDERAL PROGRAM WERE INADEQUATELY RECORDED

As indicated in your report, the Federal Trust Fund was created by Statute in 1978 for the deposit of federal funds received by the State. Since then, statutory changes have created exemptions to the requirements for all federal funds to be deposited in the Federal Trust Fund. We have directed departments to notify the State Controller of receipts of federal funds that are not deposited in the Federal Trust Fund.

The state's accounting system will need substantial modification to meet all federal and state requirements. The system does not currently allow a cross-over between receipts and subsequent disbursements by federal program. Required changes will be addressed in relation to other priorities and costs.

RECIPIENTS OF STATE AND FEDERAL MONEYS ARE INADEQUATELY MONITORED

The monitoring of federal funds to subrecipients is the responsibility of individual state agencies as detailed in Section 20050 of the State Administrative Manual. We plan on developing a reporting mechanism to provide greater oversight of departmental monitoring of local assistance funds, both state and federal.

SIGNIFICANT DEPARTMENTAL CONCERNS

We will monitor the responses to the significant departmental concerns you identified in your report and will assist the designated departments, where necessary, in addressing these specific problems.

In regards to your specific recommendations for the Department of Finance, we will continue to:

- provide for the recording and reporting of financial information in a manner that is as consistent as possible with generally accepted accounting principles, but will continue to develop the State's budget on the legally required basis.
- provide the leadership and direction to enable the departments to produce timely and correct reports that meet the needs of the State.
- provide clear guidance to departments relating to their financial reporting and contracting procedures, through the State Administrative Manual and through Audit Memos.
- direct departments to comply with applicable State Administrative Manual requirements.
- direct departments to comply with applicable federal requirements related to federal grant moneys received.

In addition, we will continue to:

- increase the number and the scope of internal control audits necessary to ensure the financial and business practices of the State, and safeguarding and effective use of the State's assets and resources. This includes intensifying our review of the department's monitoring of recipients of federal and state moneys.
- update our audit guides for internal auditing, and issue audit memos to internal auditors and others to provide technical assistance in audit and accounting related areas.
- monitor the implementation of corrective action taken by departments.

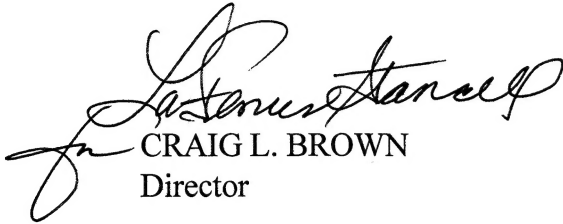
Again, we appreciate the issues that you identified to help us improve the State's operations. Our own efforts, as well as those of departmental internal auditors, have identified similar areas in need of improvement. We are aware of efforts underway by various departments in a number of areas to correct these weaknesses.

We will continue to provide the leadership to ensure the proper financial operations and business practices of the State, and to ensure that internal control structures continue to exist for the safeguarding and effective use of assets and resources.

Mr. Kurt R. Sjoberg
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If you have any questions concerning this letter, please contact Samuel E. Hull, Chief, Office of State Audits and Evaluations, at 322-2917.

Sincerely,



CRAIG L. BROWN
Director